UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67781 / September 5, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3456 / September 5, 2012

INVESTMENT COMPANY ACT OF 1934
Release No. 30193 / September 5, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15006

In the Matter of

RAYMOND J. LUCIA COMPANIES, INC. and RAYMOND J. LUCIA, SR.,

Respondents.

RESPONDENTS RAYMOND J. LUCIA, SR. AND RAYMOND J. LUCIA COMPANIES, INC.'S POST HEARING REPLY BRIEF

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Respondents Raymond J. Lucia, Sr. ("Lucia") and Raymond J. Lucia Companies, Inc. ("RJLC")(collectively, "Respondents") hereby respectfully submit their Post-Hearing Reply Brief.[1]

I. INTRODUCTION

The Division of Enforcement's ("Division") post hearing brief ("Division's Brief") is remarkable for its absolute refusal to address the dispositive exculpatory evidence presented by Respondents. The Division has the burden of proof for each claim alleged in the Order Instituting Proceedings ("OIP") and must prove each element by a preponderance of the evidence.[2] Given the evidence introduced at the Hearing, it is not surprising that the Division now attempts to replead its case, misrepresents the testimony, refers to "evidence" without citation and ignores the overwhelming unrebutted evidence supporting a dismissal of the OIP.

Much like its conscious decision to disregard the context of the Buckets of Money ("BOM") seminar PowerPoint presentation ("PowerPoint" or "slides"), which were not distributed without Lucia's narration and manually drawn illustrations; the Division wholly ignores the unrebutted evidence that 1) in 2003, Securities Exchange Commission ("SEC") examiners reviewed the PowerPoint, including the slides which are the focal point of the Division's allegations, and communicated no concern to Respondents; 2) in 2003, the SEC examiners determined that RJLC's marketing materials, including the PowerPoint, were not performance advertising; 3) the slides at issue[3] were submitted to multiple layers of independent

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1 The Division's Exhibits and Respondents' Exhibits will be cited herein as "DX __," and "RX __." The hearing transcript will be cited as "Tr. __." The Division's Brief will be cited as "DB __."

2 *Steadman v. SEC*, 450 U.S. 91, 96 (1981).

3 The slides at issue are two hypothetical illustrations. The first demonstrates how the BOM strategy, with investors identified as "Bold Bucketeers," performs in comparison to a 100% stock portfolio and a 60/40 stock/bond portfolio assuming retirement on January 1, 1973, a

compliance review and no red flags were raised; 4) of the 50,000 "reasonable investors" who attended a BOM seminar, **not a single person complained** about the Illustrations or contended he or she suffered any monetary loss as the result of a BOM seminar; 5) the SEC has issued no guidance as to what constitutes performance advertising and therefore, the OIP violates Respondents' due process rights; 6) Lucia specifically told the seminar attendees that the inflation rate utilized in the Illustrations was **not actual,** was assumed,[4] and that the actual inflation rate for the period at issue was **higher**; 7) any BOM seminar attendee who met with a RJLC advisor discussed and received appropriate disclosures concerning inflation rates, REIT rates and fees, advisory fees and portfolio reallocation;[5] and 8) the BOM withdrawal strategy is not something a potential investor could "buy" because there is no "portfolio" of identifiable securities being offered or presented at the seminar and the implementation of the BOM strategy requires determining, based on individual needs and income sources, customized allocations to the buckets – including time horizons, number of buckets, assumed rates of return and inflation, rebalancing frequency, and specific dollar amounts - as well as a selection of specific securities from tens of thousands of potential investment combinations.[6]

$1 million retirement portfolio, $60,000 annual income withdrawal, a 3% assumed inflation rate, a 7.75% REIT rate of return, stock performance based on the S&P 500, an unmanaged index, and actual treasury rates of return to calculate fixed income/bond returns (the "'73 Illustration"). The second illustration demonstrates how the BOM strategy performs in comparison to a 60/40 stock/bond portfolio assuming retirement on January 1, 1966, a $1 million retirement portfolio, $60,000 annual income withdrawal, a 3% assumed inflation rate, a 7.0% REIT rate of return, stock performance based on the S&P 500, and actual treasury rates of return to calculate fixed income/bond returns (the "'66 Illustration")(collectively, the "Illustrations").

[4] SEC examiner Bryan Bennett ("Bennett") testified that he understood the 3% inflation rate was "assumed" and not actual. Tr. 136-37.

[5] To the extent the Division's omission of any argument or position concerning this evidence is an attempt to thwart Respondents' ability to respond to such arguments, such conduct is improper and highly prejudicial and Respondents will seek leave from this Court to submit additional responsive briefing.

[6] Tr. 1626, 1639-40.

The Division's Brief also ignores the substantial unrebutted testimony that at the time the Illustrations were in use, Respondents' understanding and use of the term "back-test" differed from the definition the Division first announced with the filing of the OIP.[7] While the Division attempts to ascribe an evil intent to Respondents' understanding of the term "back-test," the Division has yet to explain why the 2003 SEC examiners and RJLC's supervising broker dealers, Securities America and First Allied Securities, did not question Respondents' use of the term on the seminar slides or why American Funds, Financial Engines, Vanguard and Fidelity currently utilize Respondents' definition of the term "back-test" in their retirement planning advertising materials. Respondents presented unrebutted testimony that the standard within the retirement planning industry is to utilize the term "back-test" for illustrations demonstrating the effect of historical rates of return for investments on **hypothetical distribution rates**. Tr. 852-854. The Division's Brief is silent as to this evidence.

In addition, the Division continues to refuse to acknowledge that Rule 204-2(a)(16) is wholly inapplicable to the Illustrations. This Rule requires investment advisers to maintain documents necessary to demonstrate the calculation of the performance of any **managed account** or **securities recommendation**. Even the Division's key witness, SEC examiner Bennett admitted that the "back-test" Illustrations did not calculate the performance of any managed account or securities recommendation. The Division is silent as to how it proposes to get around this constraint. The reason the Division is so loathe to admit Rule 204-2(a)(16) does not apply here is because it is the sole contrived avenue for the Division to assert that two spreadsheets,[8] **which were never circulated to the public**, are the basis for a securities

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[7] Prior to the filing of the OIP, neither the Division nor the SEC have ever announced that it would be misleading to use average as opposed to actual annual inflation rates. See RX 46.

[8] The spreadsheets are Division's Exhibits 12 and 13 (collectively, the "Spreadsheets").

violation. Tr. 1149-50. To be clear, Rule 204-2(a)(16) does not apply here, Respondents were not required to maintain the Spreadsheets, the Spreadsheets are not evidence of any securities violation, and the Division's expert's reliance on the Spreadsheets as a basis for his opinion that the seminar attendees were misled is futile.

With respect to performance advertising, the Division attempts to fit the square peg of performance advertising into the round hole of retirement planning illustrations and fails to cite any applicable legal authority for the proposition that the Illustrations are performance advertising. The Illustrations do **not** advertise the performance of any managed account or any recommended security, but instead, in the context of a retirement planning presentation, compare the asset longevity of the BOM retirement withdrawal strategy to other retirement withdrawal strategies. Lucia is a financial planner specializing in retirement planning and is not a money manager.[9] The Division's Brief does not cite to any authority to support a finding that a retirement withdrawal strategy that does not identify any specific security, portfolio, fund, account or asset that a potential investor could purchase is performance advertising. To the contrary, in each case cited by the Division, the alleged misrepresentation concerns the performance of client accounts or securities recommendations. The allegations here are unprecedented and the Respondents did not receive adequate notice that the SEC would consider their conduct in violation of any securities law. *See FCC v. Fox Television Stations, Inc.*, 567 U.S. ___, No. 10-1293 (June 21, 2012); *Christopher v. Smithkline Beecham Corp.*, 567 U.S. ___, 132 S. Ct. 2156 (2012).

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9 A money manager researches, selects, and monitors the performance of the securities a mutual fund purchases and charges a fee. Tr. 1664. http://www.sec.gov/investor/pubs/inwsmf.htm

Moreover, the Division's assertion that seminar attendees could "buy" the BOM strategy has not and cannot be proven. The challenge for the Division by pursuing this novel, but hopeless, theory is that it creates even stronger grounds for this Court to find Respondents' due process rights have been violated. At what point has the Commission given fair notice to investment advisers that a retirement planning withdrawal strategy, that is not comprised of any underlying products that can be purchased, can be used to allege that an investment adviser received compensation even where there is no linkage between any compensation received by the adviser and any investment, and where the adviser has no communication with the investor regarding any investments purchased? See *Id.* With each new violation premise proposed by the Division, this proceeding slips further into a due process abyss.

Finally, because the Division has failed to prove any securities violation by Respondents, no sanctions or penalties are warranted. The Division's characterization of Respondents' conduct as egregious, involving a high level of scienter and lacking candor is belied by the evidence presented at the hearing. Finally, instead of admitting it has failed to prove third tier penalties, the Division doubles down and asks this Court to impose monetary penalties that would financially destroy Respondents and it does so without even the pretense of actually supporting its request for third tier penalties with **actual evidence.**

II. LEGAL ARGUMENT

The evidence presented conclusively demonstrates that the Division cannot meet its burden of proof. First, because the Illustrations are not calculations of the performance of managed accounts or securities recommendations, there can be no violation of Rule 204-2(a)(16) and the Division's effort to use the Spreadsheets as a basis for a securities violation is unsupportable. Second, the Division's assertion that Respondents' did not offer any evidence to

"contradict" the Division's definition of a "back-test" is a blatant attempt to confuse the record. Respondents offered unrebutted evidence that they were utilizing a different definition of "back-test," a definition accepted as the standard in the **retirement planning industry** and accepted by RJLC's supervising broker dealers and the 2003 SEC examiners. Respondents also offered considerable unrebutted evidence that the Division's definition of "back-test" is not one that was articulated prior to the filing of the OIP. Third, the Division ignores the fact that the Illustrations are **not performance advertising**. Although the Division attempts to sidestep an assessment of the composition of the contents of the investments which comprise the Illustrations by referring to BOM as a "portfolio" and improperly stating that an investor could "buy" the BOM strategy, this distortion of the evidence was repudiated by the Hearing witnesses. Notably, the Division's Brief does not cite a single authority expanding the scope of performance advertising regulation beyond the performance of managed accounts, client accounts or specific identified securities transactions. Fourth, although the Division makes much of the two errors on the '73 Illustration slide, these errors are not pled. The Division was made aware of one error when, prior to the Hearing, Respondents' expert **volunteered** the existence of the mathematical error. After learning of the error, the Division made no effort to amend the OIP to allege that the error rendered the '73 Illustration misleading to potential investors. The second potential error, the possible existence of which Respondents also **volunteered**, is a partially inaccurate disclosure. However, the Division did not prove that this potential error rendered the '73 Illustration misleading to investors and the evidence concerning the error is that it resulted in understating, not overstating, the ending balance of the BOM withdrawal strategy in the '73 Illustration. Accordingly, these errors do not support a finding of scienter or negligence based Section 206 violations. For these reasons, this proceeding should be dismissed.

A. **Rule 204-2(a)(16) Cannot Be Applicable To The Illustrations As The Calculations Therein Do Not Relate To The Performance Of Any Managed Account Or Securities Recommendation.**

Rule 204-2(a)(16) requires that an investment adviser maintain:

> all accounts, books, internal working papers, and any other records or documents that are **necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all *managed accounts or securities recommendations* in any notice, circular, advertisement,** newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with the investment adviser) . . . (emphasis added).

By its clear language, this Rule only applies to the advertised performance calculations of a **managed account or securities recommendation.** Respondents presented substantial evidence that the BOM PowerPoint and the Illustrations do not demonstrate the calculation of the performance or rate of return of any **managed account or securities recommendation.** Tr. 142, 571, 572, 1274, 1281, 1284, 1594, 1597.[10] The Division presented no rebuttal evidence. Bennett's admission that the Illustrations do not calculate the performance or rate of return of any managed account or securities recommendation is conclusive evidence that the Rule 204-2(a)(16) claim should be dismissed. Tr. 176-177. Not only are the Illustrations unrelated to any managed accounts or securities recommendation, there is uncontroverted evidence that RJLC advisors *never recommended specific securities* to investors for their BOM plans. Tr. 732.[11]

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[10] During the seminar presentations, Lucia does not promote or sell any specific stock, bond, mutual fund, annuity, real estate investment, or managed portfolio and does not make any promise or prediction as to the return on any investment portfolio. Tr. 142, 571-72, 1274, 1281, 1284, 1594, 1597. The Division presented no rebuttal evidence.

[11] Lucia testified that the Illustrations do not represent in any respect any calculation or rate of return of any managed account or securities recommendation. Tr. 1340. RJLC advisor, Janean Stripe ("Stripe") testified that during the BOM seminars Lucia never discusses the performance of any managed account or a securities recommendation. Tr. 1594.

Moreover, there are no reported decisions, SEC No-Action letters or other guidance in which the Division or the Commission has taken the position asserted here, that Rule 204-2(a)(16) is applicable to illustrations comparing various retirement withdrawal strategies which do not calculate the performance of a managed account or securities recommendation. Thus, there is no requirement that records be maintained to support any calculations contained therein and there can be no violation of Rule 204-2(a)(16).

The authority cited in the Division's Brief exposes the utter lack of any basis for finding a Rule 204-2(a)(16) violation. Instead of attempting to explain how this Rule could possibly be applicable to the Illustrations, the Division merely cites to a November 5, 1987 Proposal of Rule Amendments[12] and a settlement order.[13] A review of the Proposal of Rule Amendments, actually supports Respondents' position that Rule 204-2(a)(16) does not apply to the Illustrations. In explaining the purpose of the *proposed* Rule amendment to revise record keeping requirements, the Commission invites public comment and states:

> As part of the Commission's adviser inspection program, Commission staff routinely examines adviser advertisements for compliance with the adviser advertising rule, Rule 206(4)-1, which prohibits false or misleading adviser advertisements. **When the advertisements contain information about the performance of advisory accounts or securities recommendations, the staff examines the basis for this performance information.**

Accordingly, this Proposal reiterates the SEC's position that this record keeping requirement pertains to the performance of **advisory accounts** and **securities recommendations**, which are not present in the Illustrations. The Division blithely disregards

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12 Investment Advisers Act Release No. IA-1093 (November 5, 1987).

13 *In the Matter of Market Timing Systems, Inc.*, Rel. No. IA-2048 (Aug. 28, 2002). This easily distinguishable settlement order specifically asserts that the respondent "failed to disclose that [respondents'] **actual performance with client accounts** during first quarter was materially less than []advertised hypothetical results for the same period." Accordingly, this settlement provides no a legal basis, and there is none, for a Rule 204-2(a)(16) violation against RJLC.

the parameters of Rule 204-2(a)(16) for one reason, it is the pretext for asserting securities violations based on the Spreadsheets. However, this baseless contrivance fails. Because the Illustrations do not calculate the performance of any managed account or securities recommendation, **there is no requirement that any documentation regarding any calculation be maintained, and whether or not the Spreadsheets "match" or support the Illustrations is irrelevant for purposes of a finding securities violation.** As there is no legal or factual basis for a violation by RJLC of Rule 204-2(a)(16), this claim should be dismissed.

1. The Spreadsheets Cannot Be the Basis For A Securities Violation.

Throughout the Division's investigation, Respondents have consistently asserted that Rule 204-2(a)(16) does not require RJLC to maintain documentation supporting the Illustrations and that the Spreadsheets are not support for the Illustrations. The Division has consistently ignored this position and have seized onto the Spreadsheets to manufacture violations. In addition to the fact that Rule 204-2(a)(16) does not require RJLC to maintain any documentation of the calculations in the Illustrations, the unrebutted evidence is that the Spreadsheets are not and were never intended to be support for the Illustrations.

Bennett testified that when he asked RJLC financial planning supervisor, Richard Plum ("Plum") why the '73 Illustration did not match the Exhibit 13, the 1973-2003 spreadsheet ("'73 Spreadsheet"), Plum told him that the "slide show was supposed to be kind of a forward looking exercise." Tr. 91. Plum also told Bennett "that all of the calculations were done by a calculator. **So that's why they did not have anything on spreadsheets to further provide to us as backup.**" Tr. 92. Bennett's testimony is corroborated by his interview notes of Plum which show that in response to Bennett's question regarding why the '73 Illustration did not match the '73 Spreadsheet, Plum responds, "This [the '73 Illustration] is more of a hypothetical, **not on a**

spreadsheet. This is designed more of a prospective basis, not using todays . . ." RX 54 SEC-LA3937-1021. Respondents' consistent position that the '73 Spreadsheet is not support for the '73 Illustration is also articulated in the Staff's December 17, 2010 deficiency letter which states, "RJL personnel then informed the staff that the performance figures reflected in the seminar were calculated by calculator and that RJL **did not have documentation of the calculations.**"

Bennett also testified that during the exam the SEC "asked for **any supporting documentation of any back-testing done.**" Tr. 87. In response, RJLC produced an Excel file which the Division contends contained a single spreadsheet and Respondents contend contained more than one spreadsheet. Tr. 87.[14] Irrespective of whether the Staff was able to access more than one spreadsheet from the Excel file, the point is that Respondents never represented to the SEC that the Spreadsheets in the produced Excel file were support for the Illustrations. Instead, the Excel file was provided to the Division in response to the request for any supporting documentation of "any back-testing" done.

Additionally, during the Hearing, Plum, Lucia and Raymond Lucia, Jr. ("Lucia, Jr.") all testified that the '73 Spreadsheet and Exhibit 12, the 1966-2003 spreadsheet ("'66 Spreadsheet) were created in preparation for a meeting Lucia had with Ben Stein. Tr. 791-92, 800-801, 1268-69, 1686. Plum also testified that he created the '73 Spreadsheet, **and it was not created as support for the '73 Illustration in the slideshow.** Tr. 801. This is unrebutted evidence that the SEC and Division were consistently advised that the '73 Spreadsheet was not support for the '73 Illustration. As shown above, the unrebutted evidence is that even with the knowledge that the Spreadsheets were not created as support for the Illustrations, and fully aware that the

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[14] Bennett and RJLC Compliance officer Theresa Ochs ("Ochs") both testified that she provided the Staff with an "Excel file." Tr. 88, 542. The purpose of using an Excel file is the ability to run various scenarios using different inputs.

Spreadsheets were **never disseminated to the public**, the Division made a tactical decision to use the Spreadsheets as the means to prove its case. Tr. 860-61. As a result, the Division's case collapses.

2. Grenadier's Opinion, Which Is Based On The Spreadsheets, Does Not Support A Finding That The Illustrations Are Misleading.

The reason the Division so desperately clings to the Spreadsheets is that their expert, Dr. Steven Grenadier ("Grenadier") bases his opinion not on the Illustrations, but instead on the Spreadsheets. Tr. 930-32; DX 70 ¶¶ 1, 3, 5-19, 23-28, 31-34. Grenadier opines, admittedly without any idea as to what the seminar attendees saw or heard or the context of the presentation of the Illustrations, that anyone who saw the Illustrations was misled. Tr. 963-64, 985-86, 988-89. Grenadier also admits that he has no knowledge as to any disclosures made by RJLC to potential investors concerning inflation rates, REIT rates of return, fees and reallocation, and did not review the comparison withdrawal strategies. Tr. 985-86, 998-99. Instead of considering this evidence, which the Division could have made available to him, Grenadier bases his opinion on the Spreadsheets. Tr. 930 - 32, DX 70. Grenadier's Report states, "[t]here are two spreadsheets that I understand are represented by Respondents as empirical support for the 'back-tests' of the Buckets of Money strategy as outlined in the presentation " and "[t]he spreadsheets represented as support for the performance results laid out in the presentation and as back-test of the Buckets of Money strategy are in fact not back-tests." DX 70 SEC EX 004-5.[15] Clearly, Respondents never represented to Grenadier that the Spreadsheets supported the Illustrations.[16] Instead, this

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[15] **Even Grenadier's Report recognizes that the assumptions and results in the '73 Illustration do not comport with the results in the '73 Spreadsheet.** DX 70, SEC EX 005.

[16] In his Report, Grenadier cites to Respondents' Answers as support for his reliance on the Spreadsheets. However, as cited, the Answers state, "Answering Paragraph B.17 of the Order [Respondents] admit the 1966 and 1973 Spreadsheets, **and numerous other sources, validate**

flawed representation was made by the Division. Grenadier's erroneous assumption that he could base his opinion on the Spreadsheets results in a number of inaccurate conclusions.

First, Grenadier's opinion that the REIT rate of return assumed in the Spreadsheets should be compared to the NAREIT all REIT index, instead of the NAREIT Equity Index, is based on his view that the Spreadsheets did not specify the REIT investment. DX 70, SEC EX 014. Of course, had Grenadier reviewed the PowerPoint or viewed the February 2009 Webinar ("Webinar"), he would have seen that the PowerPoint specifically references the NAREIT Equity Index[17] and that during the seminar Lucia repeatedly states that the use of the term "REIT" on the Illustration slides is shorthand for direct ownership in real estate. Tr. 963-64; RX 30, 33:13, DX 66, 34:12-17, DX 66, 35:3-8. During the Webinar and at the BOM seminars, when discussing the '66 Illustration, Lucia states, "Let's assume we put forty percent in T-bills, twenty percent in **direct ownership in real estate** . . . ." DX 66, 50:3-5. This evidence demonstrates the error of Grenadier's opinion that the NAREIT all REIT index, with its lower rate of return, instead of the NAREIT Equity Index, is the appropriate index to utilize for considering whether the assumed REIT rate of return was misleading. Tr. 1376.

Second, because the Division did not give Grenadier access to the Webinar or the transcript of the Webinar it prepared, Grenadier employed a REIT sales strategy that was

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the slideshow's premise – that the BOM investment strategy provides superior outcomes in relation to other investment strategies." Answers of Respondents to OIP, ¶ 19. The Answers do not provide support for Grenadier's opinion that the Spreadsheets are back-up calculations for the Illustrations. The Answers comport with Respondents' defense, that Lucia relied on multiple independent retirement planning and academic studies to validate the superiority of BOM over other withdrawal strategies. Accordingly, Grenadier's reliance on the Spreadsheets to form an opinion regarding the Illustrations is misplaced.

[17] This is the index relied on by Respondents' REIT expert, Kevin Gannon ("Gannon") to support his opinion that the REIT return rate assumed in the Illustrations was reasonable and extremely conservative. Tr. 1366-9, 1374-75; 1387, 1391-92; RX 3, SEC-LA3937-00149, RX 34.

antithetical to that advocated by Lucia during the seminars. Tr. 1296. During the seminar, Lucia explains that direct-ownership in real estate is an important component of the BOM strategy because of the growth potential and the non-correlative nature of real estate returns to stock returns. RX 33:18-35:06, DX 66, 34:3-35:16; see also Tr. 1621-1622.[18] The strategy espoused by Lucia during the seminars is to liquidate assets that have increased in value, not decreased. Tr. 1296. RX 33:18-36:06. Grenadier's methodology was the opposite, selling the REITs at a significant loss at a time when the REIT returns are lower than the stock returns. Tr. 1296-97; DX 70, SEC EX 039-40. Lucia also advises the seminar attendees that REITs are a long term, ten plus year, investment. TR. 1297-98; RX 3, SEC-LA3937-00148, 180. As Lucia, Jr. testified, a "liquidity event" is when a REIT goes full cycle and it represents the full cycle nature of the investment and giving the investors the opportunity to take back their net investment in that investment and reinvest elsewhere. Tr. 1392, 1623. Respondents advise their clients to expect a 10-15 year time frame for a liquidity event to occur. Tr. 1623; RX 3, SEC-LA3937-00148, 180.[19]

Under Grenadier's methodology, he began liquidating the REIT investment in year 8 for his 1966-2003 spreadsheet (at a 33.1% loss) and in year 1 for his 1973-2003 spreadsheet (at a 33.1% loss). DX 70, SEC EX 039-40. The effect of using this methodology was drastically to decrease the value of the assets at the beginning of the investment period, thus accelerating the time within which the assets are depleted. As Grenadier's methodology is inconsistent with the strategy described to the seminar attendees, it does not support a finding that the Illustrations were misleading.

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[18] Gannon's testimony supports this view. Tr. 1372-73.

[19] Lucia, Jr. testified that during the Hearing an announcement was made regarding a liquidity event for ARC Trust III, a product offered to clients which garnered a 20% return for investors. Tr. 1624, see also, Tr. 1370-71, 1393-94.

Third, because the Division did not give Grenadier access to the Webinar or the Webinar transcript, Grenadier's conclusion that "Respondents' presentation does not clearly explain the particular investment strategy being implemented" is wrong. Tr. 963-64; DX 70 ¶¶ 29-31. As shown in the Webinar, immediately following the explanation which accompanies the '66 Illustration, Lucia manually draws out a more detailed BOM plan and discusses fees, inflation, reallocation, dividends and real estate investments. RX 30, 53:24-1:10:45, DX 66, 53:2-69:5. At this point in the seminar, Lucia specifically discusses the BOM hypothetical illustration at year 15 and the **risks and effect of being 100% invested in stocks.** RX 30, 1:02:32 – 1:10:40, DX 66, 62:1-69:4. **Lucia also specifically discusses what would happen if the stock market imploded at year 15 and what would happen if all the companies the investors were invested in stopped paying dividends in year 15.** RX 30, 1:06:24 – 1:10:40, DX 66, 62:1-69:4. This is the most in-depth description of how the BOM strategy works, but **only the seminar attendees,** not the SEC examiners or Grenadier, took the opportunity to consider this material. The Division's tactical decision to prevent Grenadier from considering the information that the seminar attendees saw and heard creates flawed assumptions upon which Grenadier bases his erroneous opinion that Lucia did not explain the BOM strategy.

Fourth, Grenadier's opinion that Respondents' use of a 3% average inflation rate was "very misleading" does not take into account Lucia specifically telling the seminar attendees that it was an assumed, hypothetical average inflation rate and that the actual inflation rate for the time period was higher. Tr. 777, 963, 1138, 1146, 1547, 1686; RX 30, 48:10, DX 66, 48:21-49:2. Grenadier also did not take into account that all the comparison withdrawal strategies use a 3% assumed inflation rate and, in addition to the multiple disclaimers in the PowerPoint, Lucia consistently references an "assumed" 3% inflation rate **eleven times** during the Webinar. Tr.

963, 998-999; DX 66, 14:4-5, 39:8-9, 45:22-23, 48:24-49:2, 49:4-5, 49:10-11, 54:4-5, 56:25, 63:7-8, 64:11-12, 68:11-12. Instead, Grenadier's myopic opinion is based on the Spreadsheets, and not on the representations made to the seminar attendees. As shown above, Respondents did not represent that the Spreadsheets are support for the Illustrations. The Division made this inaccurate representation to Grenadier, and it invalidates Grenadier's opinion.

B. **The Division Has Failed To Establish A Violation Of Section 206(1) or (2).**

As shown in Respondents' Post-Hearing Brief and herein, the Division has failed to prove the required elements of a Section 206(1) violation, namely that RJLC made false and misleading statements to its clients or prospective clients; failed to disclose a material fact and acted with scienter. *Morris v. Wachovia Sec., Inc.*, 277 F. Supp.2d 622, 644 (E.D. Va. 2003). The Division argues that Respondents' use of the term "back-test" in the Illustrations was false and misleading and material without acknowledging that substantial unrebutted evidence was presented at the Hearing that Respondents use of the term "back-test" for a hypothetical which uses historical investment return rates and hypothetical withdrawal and inflation rates comports with the retirement planning industry standard. Respondents' position is bolstered by the unrebutted evidence that use of the term "back-test" was never identified as a potential violation by the SEC's 2003 examination staff or RJLC's supervising broker dealers. The Division also fails to acknowledge that in violation of Respondents' due process rights, the definition of "back-test" it now advocates has not been articulated to investment advisers prior to the filing of the OIP. Further, the Division fails to address *SEC v. Goble* and its ruling that materiality does not include a representation that would only influence an individual's choice of investment advisers.[20] Finally, the Division's feeble basis for scienter is that Lucia knew a higher inflation

[20] 682 F.3d 934, 944 (11th Cir. 2012).

rate would alter the results of the Illustration. Apart from the fact that the result is elementary math, the Division wholly ignores the context of the Illustrations and Lucia's specific **oral** disclosure to the attendees that the inflation rate during the time period was higher, and the purpose of the Illustrations – to compare BOM to other withdrawal strategies.

1. Respondents Presented Substantial Unrebutted Evidence That The Illustrations Utilize The Term "Back-Test" As That Term Is Used In The Retirement Planning Industry, Not As Articulated By The Division For The First Time In This Enforcement Proceeding.

The Division's Brief contends that Respondents presented inconsistent evidence as to whether they "back-tested" the BOM strategy. DB, p. 13. This statement is not true and wholly unsupported by the evidence. Since March 2010, beginning with the 2010 SEC examiners' initial inquiries of RJLC supervisor Plum concerning the Illustrations, Respondents have consistently taken the position that the Illustrations were **not "back-tests" as the Division now defines that term.**[21] Tr. 91, 899-902; RX SEC-LA3937-1021. Instead, Respondents termed the Illustrations "back-tests" in accordance with the retirement planning industry standard for use of the term. Tr. 836-838; RX 46. What is at play here are two definitions for the term "back-test." The first is Grenadier's definition, "[a] back-test goes backwards in time and sees how a portfolio strategy would have done had it been implemented in the past." Tr. 933.[22] For purposes of this proceeding, the Division has adopted Grenadier's definition of the term "back-test" and

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21 Hence the use of the term "so-called back-test" at the Hearing.

22 The Division Brief recognizes this distinction in the citation to Respondent' expert, Dr. John Hekman's ("Hekman") testimony:

> Q. It's not your opinion, is it, that any of the calculations performed in the slides that Mr. Lucia presented in his seminars are back-tested **as Dr. Grenadier defined the term**?
>
> A. That's correct. I don't consider them to be back-tests.

Tr. 1541-42.

expanded the definition to include the prerequisites that a correct "back-test" is not conducted if the registrant uses an average inflation rate instead of actual annual inflation rates; assumes a REIT rate of return and does not deduct hypothetical advisory fees. Tr. 932-33. **This is not a definition or standard the SEC has previously articulated.**[23]

The second "back-test" definition is the one utilized in the retirement planning industry. Under this definition, "back-tested" illustrations demonstrate the hypothetical "what if scenario" of the forward-looking effect of historical rates of return (i.e., the S&P 500, or a mutual fund) on hypothetical inflation and distribution rates.[24] Tr. 837-839, 852-854. As Lucia testified, "there's just an enormous disconnect between my interpretation of what a back-test was and the Division's interpretation of what a back-test was." Tr. 1269. Plum similarly testified that at the time the Illustrations were in use, his understanding of a "back-test" was illustrating historical time horizons with hypothetical distributions. Tr. 837. Plum's testimony comports with Bennett's testimony that during the 2010 Exam fieldwork, when asked about the inflation rate, Plum told him that the Illustrations were supposed to be a "forward-looking exercise." Tr. 91, 900.[25] Bennett's compilation of notes of interviews conducted during the 2010 Exam memorializes a March 12, 2010 conversation Bennett had with Plum. RX 54. The interview notes reflect that Bennett asked Plum to explain why the "back-testing for [the '73 Illustration] doesn't appear to match the spreadsheet we were given." Tr. 91, 203; RX 54, SEC-LA3937-

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[23] This is a violation of Respondents' due process rights. *Christopher v. Smithkline Beecham Corp., supra*, 567 U.S. ___, 132 S. Ct. 2156.

[24] The retirement planning industry "back-tests" a "What if" scenario, meaning what if a retiree today experiences the same or similar rates of return of a historical data set as applied to their personal assumptions for inflation and withdrawals, demonstrating the chances of success of a particular withdrawal strategy.

[25] The Division's Brief asserts that Respondents coined a new term - "forward looking back-tests" - at the Hearing. Bennett's testimony refutes that assertion.

1021. Plum responds, "**This is a hypothetical, not on a spreadsheet.** This is designed more of a **prospective basis**, using today's . . ." Tr. 900-903; RX 54 (emphasis added.).

The Division's Brief states "Respondents did not offer any evidence to contradict [Grenadier's definition of back-test]." DB, p. 12. This argument purposefully distorts the evidence. Respondents do not contradict that Grenadier's definition is an academic definition of a "back-test." However, **and this is the crux of this proceeding**, Respondents presented considerable unrebutted evidence that when using the term "back-test" in the PowerPoint, Lucia was using a different definition of "back-test," a definition that is consistent with the retirement planning industry standard and which was sanctioned by the 2003 SEC examiners and RJLC's supervising broker dealers.

For purposes of this proceeding, Grenadier's definition of "back-test" is irrelevant. Respondents have never taken the position that the Illustrations were "back-tests" as that term is defined by Grenadier. Indeed, Respondents were baffled by the Division's decision to spend enormous sums for an opinion from Grenadier that, using his definition, the Illustrations are not "back-tests." Respondents would have stipulated to that. The Division's attempt to obfuscate this distinction is telling as it is only through a conscious disregard of Respondents' consistent position regarding the term "back-test" that the Division can cobble together an argument.

At all times, including Plum's advising Bennett during the 2010 Exam that the Illustrations were "forward- looking," and not "back-tests," Respondents' position has been consistent. As another example, Respondents' written response to the December 17, 2010 deficiency letter states, "[t]he illustrations in the [PowerPoint] that the staff considers a 'back-test' **were never intended to be a back test** as it relates to 'Model Portfolios,' but rather a hypothetical illustration and comparison of several common retirement planning methodologies

against a [BOM] hypothetical illustration." Tr. 91, 203, 900; RX 10, p. 4; RX 54, SEC-LA3937-1021. Hekman offered a consistent opinion in his Report and Hearing testimony as did Lucia, Ochs, Plum and Lucia, Jr. Tr. 836-837, 900-903, 1092, 1269, 1421, 1541-42; RX 35.

Respondents also offered unrebutted testimony that the meaning they ascribed to the term "back-test" is consistent with the retirement planning industry standard. Plum, Lucia, Stripe and Lucia, Jr. offered extensive testimony concerning the retirement planning industry standard for the term "back-test," which illustrates historical returns and makes assumptions based on future income or spending needs. Tr. 837-838, 852-854, 903-904, 1093, 1269-1270, 1146, 1570-73, 1627-31; RX 46, 47, 59. These witnesses also testified that marketing material currently distributed by variable annuity companies, insurance companies and mutual fund companies including Morningstar, Financeware, American Funds, Vanguard and Fidelity use this definition of the term "back-test."[26] Tr. 837-838, 852-854, 903-904, 1093, 1147, 1269-1270, 1570-73, 1627-31; RX 46, 47, 59. The Division offered **no evidence in rebuttal** and ignores this evidence in their Brief.

As an example, American Funds' marketing material, is unrebutted evidence that the definition of "back-test" within the retirement planning industry is consistent with Respondents' definition of "back-test." See Tr. 837-838, 852-854, 1093, 1269-1270, 1570-2, 1627-31; RX 46. American Funds is one of the "largest mutual fund companies" in the country with over a trillion dollars in assets under management. Tr. 973, 1002. American Funds' marketing material, which is publicly available via the Internet, contains two charts which illustrate American Funds' definition of "**Back-testing**." RX 46. Chart 1 is labeled "**Back-testing** withdrawal rates on

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[26] Presumably, if the Commission had clearly articulated its definition of "back-test," these major institutions would utilize different terminology and/or methodology for retirement planning illustrations.

indexes" and tests 25 rolling 25-year periods from 1961-2010[27] using stocks and bonds based on historical index returns to represent the survival rate for a variety of asset mixes at withdrawal rates of 4%, 5% and 6%. The "**Back-test**" in Chart 1 uses a **4% average inflation rate** for the period 12/31/1961 to 12/31/2010 and **does not deduct advisory fees or transaction costs.** Chart 2 is labeled "**Back-testing** withdrawal rates on select American Funds," has the same 25 rolling 25-year periods from 1961-2010, and uses 11 American Funds equity funds to represent the survival rate at withdrawal rates of 4%, 5% and 6%. Chart 2 also uses a **4% average inflation rate** from 12/31/1961 to 12/31/2010. Charts 1 and 2 are instructive as both use a hypothetical **4% average inflation rate** for the historical period 12/31/1961 to 12/31/2010.[28]

When questioned regarding American Funds' marketing materials, Grenadier equivocated as to his position that it was "absolutely" misleading to use the "average inflation rate over the period 1966 to 2003." Tr. 965, 975-76. Grenadier's clear bias against Respondents and his refusal to opine consistently as to the use of an average inflation rate in a "back-test," speaks to his lack of credibility. Similarly, although Grenadier initially testified that the company he consults for, Financial Engines, does not compete with RJLC, on cross-examination, he acknowledged that Income Plus, a Financial Engines product is an "asset allocation scheme" for retirees. Tr. 903, 958. The publicly available 2011 Financial Engines Income+ - A New Approach to 401(k) Retirement Income Whitepaper illustrates a number of hypothetical scenarios for retirees, includes the "Nightmare" Equity Return Scenario which is referred to as a "**back-testing analysis.**" RX 59, p .21-22. In this "back-test," retirement distributions are

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27 This time period encompasses the time period in the Illustrations.

28 Referring to the Illustrations, Grenadier testified that utilization of an average inflation rate over the period 1966 to 2003 is misleading Tr. 965, 1011. His testimony demonstrates that while he may be familiar the term "back-test" and utilization of average inflation rates in an academic setting, he is not familiar with the current retirement planning industry standard for such illustrations.

inflated during the decade beginning in 2000 at significantly less than one percent annually, while the actual annual inflation rate during that same time period averaged approximately 2.5% per year. *Id.* Thus, the Financial Engines "back test" significantly under represents inflation. This use of the term "back-test" is consistent with the retirement planning industry standard for a "back-test" illustration. However, applying Grenadier's opinion and the Division's position as to what constitutes misleading "back testing," Financial Engines has violated securities laws.

Further, Respondents' assertion that they used the term "back-test" consistent with the retirement planning industry standard is supported by the unrebutted evidence that the 2003 examiners and RJLC's supervising broker dealers reviewed every slide in the BOM seminar PowerPoint. Tr. 564-7, 674-76, 1034, 1053, 1077, 1305, 1482-1487, 1503, 1691; RX 17-22, 29, RX 54 SEC-LA3937-1016. Additionally, RJLC's internal compliance department also reviewed the PowerPoint. Tr. 674; RX 54 SEC-LA3937-1016. The SEC and the supervising broker dealers never raised any concern that the use of the term "back-test" did not comport with the Investment Advisers Act, securities laws or might be misleading. Tr. 565-67; RX 13, RX 22.

While the Division is free to ignore the evidence set forth above, it cannot use semantic subterfuge falsely to represent to this Court that Respondents ever represented to the seminar attendees, the SEC, or the Division that the Illustrations were "back-tested" in accordance with the Division's definition of "back-testing." Further, it is particularly disingenuous of the Division to make any representation as to what Lucia told seminar attendees given that the SEC examiners admittedly refused to attend a BOM seminar and the Division patently ignores Lucia's oral seminar presentation. RX 30.

The best evidence that seminar attendees were specifically told that the Illustrations were **not using actual historical data for inflation and REIT returns,** and therefore not misled, is

the Webinar. Tr. 777, 1547, 1686; RX 30, 48:10, DX 66, 48:21-49:2. During the Webinar presentation, while showing the '66 Illustration, Lucia states, **"Let's pretend you had a million dollars. Let's also pretend you wanted 50,000 dollars per year, a reasonable five percent distribution. And let's pretend that from that point forward inflation was 3 percent. We know it was more, but we wouldn't have known that at the time."** Tr. 777, 1138, 1146, 1547, 1686; RX 30, 48:10, DX 66, 48:21-49:2.[29] The Webinar demonstrates that Lucia was simply comparing the efficacy of the BOM strategy to spend safe money before volatile money in comparison to the all equity and 60/40 stock/bond pro rata withdrawal strategies when 1) there was a significant decline in the stock market and 2) when there was a prolonged period of market stagnation. Tr. 767-769, 777-80, 840, 1097-98; 1547; RX 3, SEC-LA3937-00161-170, 199-201, 202-211, RX 30, 37:23-47:00, 47:21-50:36; DX 66 40:20-42:23, 46:14-47:14, 47:15-51:19: see also, RX 51, LA-SEC3937-005812. **As Bennett acknowledged, a potential investor coming to RJLC to have a BOM plan created and implemented would be interested in what might happen from 2012 to 2030, not what happened between 1966 and 2003.** Tr. 159. There was no attempt to mislead any potential investor into believing actual historical inflation rates or REIT rates of return were being used or that the Illustrations reflected the performance of an actual portfolio or securities recommendation, and no reasonable investor would believe his or her BOM plan would or could mirror the Illustrations, or that he or she would have a portfolio valued at $4.7 million in 37 years. Tr. 1558-59. Clearly, Lucia was not misleading any seminar attendee into believing a "back-test," as defined by the Division, was being conducted. The Division's own investor witness, Richard Desipio ("Desipio") testified that the Illustrations used

[29] This statement to the seminar attendees is conclusive evidence that the Illustrations were forward looking and demonstrated, based on certain forward looking assumptions, how the BOM withdrawal strategy was superior to other withdrawal strategies. The Division offered no evidence that a reasonable investor would not have understood this.

" . . . an acceptable [inflation] rate. So maybe three percent, three or four percent, whatever that was." Tr. 286. Desipio clearly understood a reasonable rate was being plugged in as a reasonable assumption instead of an actual annual inflation rate. Even the Division concedes that Respondents advised the seminar attendees that the inflation rates and REIT rates of return utilized are **"assumed."** DB, 11, 15, 17. Assuming two key components of a hypothetical would automatically render the hypothetical outside the constraints of the Division's definition of a "back-test."

The evidence presented by Respondents conclusively demonstrates that they have consistently taken the position that the Illustrations were not "back-tested" using the Division's definition, and that the term "back-test" which was used to describe the Illustrations was a forward-looking hypothetical using historical investment rates of return and hypothetical withdrawal and inflation rates, consistent with the retirement industry standard for the term "back-test" and as approved by the 2003 examiners and the supervising broker dealers. The Division has presented no evidence in rebuttal.

2. The Illustrations Do Not Contain An Untrue Statement Of Material Fact.

The Division has failed to prove that the alleged misrepresentations in the Illustrations were material. The standard of materiality is whether "a reasonable investor or prospective investor would have considered the information important in deciding ***whether or not to invest.***" *In the Matter of Brandt, Kelly & Simons LLC*, Initial Decision Release No. 289 (June 30, 2005) citing *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992)(emphasis added); *see also*, *Basic, Inc. v. Levinson*, 485 U.S. 224, 234 (1988)("The role of the materiality requirement is to . . . filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his *investment*

decision."); *SEC v. Goble*, 682 F.3d 934 (11th Cir. 2012); *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 359 (5th Cir. 2002) quoting *R&W Technical Servs. Ltd. v. CFTC*, 205 F.3d 165, 169 (5th Cir.), *cert. denied*, 531 U.S. 817, 121 S.Ct. 54, 148 L.Ed.2d 22 (2000); *SEC v. Slocum*, 334 F. Supp. 2d 144 (D.R.I. 2004).

Although the Division's Brief cites to two Commodity Futures Trading Commission cases[30] to support the position that materiality in the securities context includes the decision to invest with a firm, the Division does not address *SEC v. Goble*, *supra*, an Eleventh Circuit case which specifically held that the definition of materiality does not include a misrepresentation that would only influence an individuals' choice of broker dealers. *Id.* *Goble* is wholly applicable here where, at most, the Division seeks to prove that the purpose of the BOM seminar and the Illustrations was to interest prospective investors to make an appointment with a RJLC advisor. Tr. 572-73, 1072-1073. Notably, the *Goble* court specifically distinguishes one of the authorities relied on by the Division stating:

> We recognize that in *SEC v. Morgan Keegan & Co.*[31] we stated that a statement is material "if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information available." We also explained that "[t]he role of the materiality inquiry is 'to filter out the essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision." Thus, the relevant "mix" of information

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[30] These cases are easily distinguishable. In *CFTC v. Flint McClung Capital LLC*, 2012 U.S. Dist. LEXIS 25127 (D. Colo. Feb. 28, 2012), a default judgment, the court found statements material where the defendant, a corporation not registered with the CFTC, solicited customer funds for investments in **foreign currency contracts** without advising the customers that defendants were running a Ponzi scheme and that the funds were not trading as promised and the funds were being misappropriated. In *CFTC v. Commonwealth Financial Group, Inc.*, 874 F. Supp. 1345 (S.D. Fla. 1994), a civil contempt proceeding, the misrepresentations found to be material included specific **commodity recommendations**, statements concerning **specific returns customers received**, and failure to disclose that the defendant had an 80% failure rate on its recommendations. *Id.* at 1353.

[31] 678 F.3d 1233 (11th Cir. 2012).

> is those facts an investor would consider when making an investment decision. **The "total mix" test for materiality is not concerned with whether the misrepresentation would alter the mix of information available as the investor chooses a broker dealer.** *Id.* at 944 fn. 5. (internal quotations omitted)(emphasis added.).[32]

Contrary to every reported decision addressing the materiality standard, the Division's position is that an alleged misleading fact or omission made during a BOM seminar that does not relate to any identified security and where no actual investment products were even potentially identified or discussed with the attendee until after his/her BOM plan was created and investment risks were disclosed, is material to an investment decision.[33] This is not, and cannot be the law. As conclusively demonstrated, during the seminar presentations, Lucia does not promote or sell any specific stock, bond, mutual fund, annuity, real estate investment, or managed portfolio and does not make any promise or prediction as to the return on any investment portfolio. Tr. 142, 571, 572, 1274, 1281, 1284, 1594, 1597.[34]

The Division's Brief does not acknowledge the unrebutted evidence that the BOM seminar attendees **were not being asked to make an "investment decision."** Tr. 572-73, 609, 1275, 1281. Instead, the attendees decided whether to fill out a contact request to later meet with a RJLC advisor to have a BOM plan custom designed for them. Tr. 1072, 1281-82, 1559-60.

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[32] The *Goble* court also references another case cited by the Division, *SEC v. Merchant Capital, LLC*, 483 F.3d 747 (11th Cir. 2007), as supporting the *Goble* ruling regarding the lack of materiality where the misrepresentation would only influence an individual's choice of broker-dealers. *Goble, supra*, at 943. The remaining case cited by the Division as purported support for a finding of materiality is readily distinguishable. In *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding Corp.*, 320 F.3d 920 (9th Cir. 2003), the misrepresentations related directly to issues which were significant to the health of the company and **its share price.** Hence, none of the cases cited by the Division support its theory that the purported misrepresentations or omissions in the Illustrations meet the recognized materiality standard.

[33] On average, it takes 207 days from the time a seminar attendee attends a BOM seminar until he or she becomes a RJLC client and purchases a product. Tr. 1285.

[34] The Division presented no evidence that any BOM plan was misleading and admitted that it had made no allegations as to the BOM strategy. Tr. 25.

Only after discussing the potential investor's income needs and goals and preparation of a unique BOM plan would any investments be proposed to the potential investor. Tr. 730-31, 1286, 1559-1563. Further, Respondents presented unrebutted evidence that each potential investor was fully advised of the risks related to each investment, and, importantly, the risks the OIP alleges were not disclosed on the Illustrations, were disclosed when they met with an advisor. Tr. 141-42, 682, 1281, 1285-87, 1566-67.[35]

Pursuant to the materiality standard articulated by the Supreme Court in *Basic, supra*, and the Eleventh Circuit in *Goble, supra*, in order to prove materiality, the Division must connect the alleged omission to an investment decision. The Division has failed to do so. Accordingly, the alleged Section 206(1), (2) and (4) violations should be dismissed.

3. The Illustrations Are Not Misleading.

As evinced by the Webinar, the BOM seminars are a continuum of information regarding market risks and the efficacy of the BOM withdrawal strategy in comparison to other withdrawal strategies. The Webinar can be summarized as follows:

- The PowerPoint is 126 pages. RX 3, SEC-LA3937-00092-218. The first 57 pages of the PowerPoint are educational in nature, and involve an in-depth discussion of market and investment risks for investors generally and retirees specifically. Tr. 1281, 1553; RX 3, SEC-LA3937-00092-170, RX 30, 00:00-41:55.
- Following the market risk discussion, Lucia manually draws out a pie chart representing the systematic withdrawal and rebalancing strategy and illustrates the withdrawal of assets from a volatile portfolio. DX 66, 28:6-29:1, RX 30, 26:16-27:15.

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[35] The SEC acknowledges that advisory fees and REIT risks and commissions were fully disclosed by RJLC to potential investors. Tr. 141-42, 212.

- Lucia then **introduces the BOM withdrawal strategy** by manually drawing out "an oversimplified version" of BOM **using a two bucket illustration** to demonstrate spending safe money over volatile assets. DX 66, 29:2-30:6, RX 30, 27:18-28:37.
- Lucia then illustrates three comparison withdrawal strategies, namely 1) a conservative strategy where the investors have 100% of their assets in "safe" investments, CD's, money markets, bond funds, etc.; 2) a risky strategy where the investors have 100% of their investments in the "stock market" ("100% Stock Portfolio"); and 3) a "balanced" strategy where the investments are 60% stocks and 40% bonds and withdrawn proportionately ("60/40 Stock/Bond Portfolio"). Tr. 1098-1100; RX 3, SEC-LA3937-00150-170; RX 30, 37:23-41:54. For these illustrations, each strategy begins with a $1 million portfolio, withdraws $60,000 annual income, **assumes a 3% inflation rate** and invests and withdraws funds in accordance with the particular strategy. RX 3, SEC-LA3937-00150-170; RX 30, 37:23-41:55.
- For the 100% Stock Portfolio and 60/40 Stock/Bond Portfolio, Lucia then discusses how those strategies would have fared if the investors' retirement date began on January 1, 1973 when the stock market declined "41.13% Over 2 Years." Tr. 767; RX 3, SEC-LA3937-00161-170, RX 30, 39:37-41:54. In describing the retirement date, Lucia states:

> **Let's pretend for a minute** that the [100% stock investors] retired January 1, 1973. One of those last big bear markets. Of course, it could have been January 1, 2000 or God help us, January 1 in the year 2008. Nonetheless; back in 1973, remember the stock market dropped forty-one percent or so over the next two years. It took forty-three months to get back to even. And back then, it took . . . 12.8 years, for an investment in the stock market to have equaled the return of T-bills . . ." RX 30 39:35-40:27, DX 66 40:20-41:11, RX 3, SEC-LA3937-00161-65.

This statement demonstrates the hypothetical nature and context of the three illustrations, which focus on the effect of a bear market on the withdrawal strategies.

- Following these illustrations, Lucia provides a more detailed explanation of the BOM strategy and uses illustrations to demonstrate that changing one factor, spending safe money over volatile money, creates positive results in comparison to the other withdrawal strategies. Tr. 738; RX 30, 41:55–45:57, RX 3, SEC-LA3937-00171-198. Lucia also **introduces the advantages of adding direct ownership in real estate including REITs**, as part of a BOM plan. RX 3, RJL-SEC-0000161-170, 180, 199-201, RX 30, 39:37-41:53, 45:58-46:45, DX 40:20-42:23, 46:14-47:14.

- Lucia then illustrates how the BOM withdrawal strategy performs in comparison to the 100% Stock Portfolio and the 60/40 Stock/Bond Portfolios assuming the BOM investors also retire in 1973 during the "Grizzly Bear" market ("'73 Illustration"). OIP, ¶ 17; Tr. 767-769, 840, 1097-98; 1547; RX 3, SEC-LA3937-00161-170, 199-201; RX 30, 37:23-47:00; DX 40:20-42:23, 46:14-47:14, see also, RX 51, LA-SEC3937-005812. **For the '73 Illustration, the seminar attendees are told that the market conditions are identical to those articulated for the 100% Stock Portfolio and the 60/40 Stock/Equity Portfolio, namely, retirement on January 1, 1973, $1 million retirement portfolio, $60,000 annual income withdrawal, and a 3% assumed inflation rate.** Tr. 767; RX 3, SEC-LA3937-00199-201; RX 30, 45:58-46:45, DX 46:14-47:14. The '73 Illustration demonstrates that by withdrawing retirement assets in accordance with a BOM withdrawal strategy, the income lasts for a longer period of time and, therefore, the BOM strategy is superior to the comparison strategies. *Id.* see also, RX 51, LA-SEC3937-005812, fn.7.

- Lucia then compares the BOM withdrawal strategy to the 60/40 Equity/Stock Portfolio withdrawal strategy during a period of prolonged stagnant stock market returns ("'66 Illustration"). OIP, ¶ 17; Tr. 772, 1097-98, 1547; RX 3, SEC-LA3937-00202-211; RX 30,

47:21-50:36, DX 66, 47:15-51:19, RX 51, LA-SEC3937-005812. The impetus for the '66 Illustration was a conversation Lucia had with economist, Ben Stein during which the assumptions for the '66 Illustration were determined. Tr. 1268, 1687. As with the '73 Illustration, the '66 Illustration produced greater returns for longer periods of time in comparison to the 60/40 Equity/Stock Portfolio withdrawal strategy. RX 3, SEC-LA3937-00202-211; RX 30, 47:21-50-36, DX 66, 47:15-51:19. The '73 and '66 Illustration slides are not crucial to the BOM presentation and comprise less than five minutes of a two hour seminar. Tr. 1277; RX 30. **After Respondents ceased using the Illustrations in the PowerPoint, the response rate of seminar attendees who filled out a contact card to meet with an RJLC advisor did not decline.** Tr. 1633-34.

- The BOM seminar ends with Lucia manually drawing out a sample BOM plan. RX 30, 53:24-1:10:45, DX 66, 53:2-69:5. During this portion of the seminar, Lucia discusses fees, inflation, reallocation, dividends and real estate investments. *Id.* **This illustration and Lucia's accompanying explanation, the most in-depth description of how the BOM strategy works, is not in the PowerPoint and was never considered by SEC examiners or the Division.** It is during this portion of the seminar that much of the information the Division alleges was not conveyed to the attendees was in fact discussed.

Again, considering the PowerPoint presentation in a vacuum, without Lucia's narration and the manually drawn illustrations as context, does not accurately reflect the information communicated to the seminar attendees.

As demonstrated at the Hearing, it simply was impossible for a potential RJLC investor to be misled by the Illustrations. Even assuming a potential investor saw the Illustrations during a seminar and believed the inflation rate during the '73 or '66 time period was 3% and the REIT

rate was 7%, and no fees would be deducted from his or her investments, an individual who met with a RJLC adviser and got a BOM plan would be disabused of any misleading information before he or she made any investment decision. The inflation rate each potential investor chooses for his or her RJLC BOM plan and its effect is disclosed and discussed, REIT rates and risks are discussed and disclosed in the prospectus each investor receives, advisory fees and transaction costs are discussed and disclosed, and reallocation is discussed throughout the client/RJLC advisor relationship. Tr. 1286, 1296, 1558-1568. In fact, during the process when the potential investor is deciding whether to invest and what products to purchase, weeks following the seminar, the Illustrations play no part in that process. Tr. 1558-1562.[36]

a. **Respondents Use Of An Assumed 3% Inflation Rate Was Not Misleading.**

The Division's position, that use of an average inflation rate during a historical time period is misleading, is a position that has never been articulated by the SEC or the Division and would subject virtually every adviser that has advertised historical performance data to be in violation of Section 206.[37] Moreover, the Division's Brief ignores entirely that when explaining the hypothetical Illustrations, Lucia expressly tells the attendees, **"And let's pretend that from that point [1966] forward inflation was 3 percent. We know it was more, but we wouldn't have known that at the time."** Tr. 1340, 1556-57; RX 30 at 48:10, DX 66, 48:21-49:2, see also, RX 30 at 46:08, DX 60 46:14-47:14. This statement conclusively demonstrates that Lucia specifically advised the attendees that the inflation rate during the 1966 to 2003 time period was

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[36] During the Hearing, in response to this evidence, the Division elicited testimony speculating that an investor could have attended a seminar, found it to be misleading and never complained to Respondents. Tr. 1689-90. The fact the Division must resort to such tangential suppositions to rationalize the pleadings speaks volumes.

[37] For example, as shown, *supra*, American Funds advertising materials which chart "Back-testing withdrawal rates on indexes" from 1961-2010 utilize a 4% average inflation rate for that time period. RX 46.

higher than 3%, but he was using 3% consistent with the other withdrawal scenarios because the Illustration is forward looking. *Id.* Tr. 777, 870, 1340; RX 3, SEC-LA3937-00161-170, 199-201, 202-211, RX 30, 37:23-47:00, 47:21-50:36; DX 66 40:20-42:23, 46:14-47:14, 47:15-51:19.[38] This statement absolves Respondents of a finding of scienter regarding the use of a 3% inflation rate and also establishes that Respondents disclosed that the Illustration outcome would be impacted by a higher actual rate of inflation. A second grader would understand that if she takes more money out of her piggybank, she will have less money in her piggybank. Instead of addressing this exculpatory evidence, the Division pretends it doesn't exist.

Second, the Division's Brief also fails to dispute or even address the unrebutted evidence that prior to becoming a RJLC client or making an investment with RJLC, every seminar attendee received specific disclosures regarding inflation rates and the effect of inflation on retirement withdrawals. Tr. 1561-1562. Therefore, to the extent any potential investor had any misunderstanding concerning inflation rates, such understandings were corrected before any investment was made.

Third, the Division does not address the conclusive evidence that the 3% **assumed** inflation rate being utilized in all the illustrations, including the Illustrations, was not misleading. Tr. 1401, RX 35. The Consumer Price Index for Urban Consumers ("CPI-U") which is measured by the Bureau of Labor Statistics reflects an average rate of inflation from 1913 to 2010 of 3%. Tr. 964. This is relevant because during the seminars, Lucia makes clear that in discussing the Illustrations, he is using a **forward looking** inflation rate. RX 30 at 48:10, DX 66, 48:21-49:2. Hekman opined that given the statements by Lucia during the Webinar describing the Illustrations as forward looking, 3% was a reasonable inflation rate to use in the those

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[38] No seminar attendee ever complained to Respondents that the BOM seminar illustrations did not use an appropriate inflation rate. Tr. 882, 1557.

illustrations. Tr. 1401; RX 35, p. 14. Further, Plum testified that in his experience, retirees have lower rates of inflation than the CPI-U dictates and he and RJLC advisor Stripe[39] have never had a client request that his or her distributions be increased by the previous year's inflation rate. Tr. 867, 1562, see also, 1196. Given Respondents' decades long experience with retirement planning, which far exceeds that of the SEC examiners or Grenadier, they understand that a retiree's increase in spending and associated increase in retirement income distributions is generally less than the CPI-U inflation rate. Tr. 795-799, 867, 1195-96.

Finally, the purpose of the Illustrations, which is clear from the Webinar, was to show that with identical returns on bonds, identical returns on stocks, identical inflation rate and identical distributions, changing one factor – taking income distributions from safe money instead of volatile money – is a superior withdrawal strategy to the comparison strategies. Tr. 779-780, 1154; RX 30. Therefore, as long as a reasonable rate was utilized, the use of a particular inflation rate is irrelevant for purposes of the Illustrations because the same inflation rate is applied to all of the compared strategies, thereby making any comparison apples to apples. Tr. 800. Applying an inflation rate based on the average and yearly consumer price index would have only depleted an investor's funds more quickly across all strategies, but it would have had no effect on the ultimate message – the BOM withdrawal strategy preserves funds longer than the comparison strategies. Tr. 91, 122, 799-800, 816, 1154, 1403; RX 35, p. 8.

For the foregoing reasons, the use of a **disclosed "assumed"** 3% inflation rate in the Illustrations was not misleading and does not violate Section 206 of the Advisers Act.

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[39] Plum and Stripe have been affiliated with a Lucia related entity, including RJLC, and financial planners, since 1993. Tr. 713, 720, 1552. As a RJL Wealth Management ("RJLWM") advisor, Stripe currently has approximately 600 clients. Tr. 1557.

b. Respondents Use Of An Assumed REIT Dividend Rate Was Not Misleading.

Grenadier's Report regarding whether an investor would be misled as a result of certain "misleading" assumptions concerning the availability, return and liquidity of a REIT investment, are erroneous and based not on the Illustrations, but instead on the Spreadsheets. As demonstrated, *supra*, the Spreadsheets are not support for the Illustrations and, therefore, Grenadier's opinion as to the REIT assumptions is specious. See, II.A.2. As to the assumed REIT rate of return, which was disclosed as "assumed" both orally and on the PowerPoint, Gannon testified that the assumed REIT rates of return used in the Illustrations were conservative, reasonable and not misleading. Tr. 1366-69, 1387, 1391-9; RX 3 SEC-LA3937-00198, 204, RX 34, see *supra*, II.A.2.

Moreover, Grenadier's opinion and the assertions in the Division's Brief concerning REITs also fail for the simple reason that the investment labeled "REIT" in the Illustrations is not limited to REITs. Because the Staff, the Division and Grenadier did not avail themselves of the opportunity to attend a seminar or view the Webinar, they had no way of knowing that the asset class used to potentially fill one of the buckets was the broad category of direct ownership in real estate, and not limited to REITs. Tr. 1565-67. While the slides shorthand direct ownership in real estate as "REITs," the seminar attendees were advised as to the breadth of this diversified asset class. DX 66, 34:12-17; DX 66, 35:3-8. At the risk of being overly repetitive, had the SEC examiners or the Division taken the opportunity to attend a BOM seminar, they would have heard the disclosures that the seminar attendees heard and presumably would not have filed the OIP.

During the BOM seminars, Lucia repeatedly advocates that investors invest in "direct ownership in real estate" as an asset class for diversification. RX 30, 33:13. During the Webinar,

Lucia states, " . . . we really focus a lot on non-tradable *direct ownership in real estate*. Because real estate, as an asset class, has produced returns that are similar to stocks, but they get there a little different way," and " . . . I'll be referring to *direct ownership in real estate in the Buckets of Money strategy*, because it's not only a staple, it is critical in giving us stable income with not a lot of volatility . . . ." DX 66, 34:12-17; DX 66, 35:3-8. In discussing the '66 Illustration, Lucia states, "Let's assume we put forty percent in T-bills, twenty percent in *direct ownership in real estate* . . . ." DX 66, 50:3-5. (emphasis added.) This is conclusive evidence that it was disclosed to the seminar attendees that the Illustration's references to REIT investments included direct ownership in real estate and were not limited to REITs. Stripe offered additional testimony as to the reality of how direct investments in real estate fit within the REIT bucket for BOM plans, "[i]t could also be direct ownership in real estate for people that have rental property. A lot of people are doing that right now, even buying properties for cash and taking rent as their income." Tr. 1565-66.

Because the Illustrations do not identify a specific real estate investment, it would be impossible to apply an actual annual historic rate of return in the manner urged by Grenadier. Given the general description of the investment as "direct ownership in real estate" during the seminar, no reasonable investor would have inferred that Lucia was describing a specific REIT (or necessarily a REIT at all) or that the assumed rate of return was based on a specific REIT investment. Once again, when the Illustrations are considered within the context of the oral presentation, which the Illustrations are designed to supplement not supplant, there is nothing misleading about assumed REIT rates of return, why the rates are assumed, and the purpose within the BOM strategy for implementing a direct ownership in real estate investment.

Accordingly, the use of a disclosed "assumed" REIT rate of return in the Illustrations was not misleading and did not violate Section 206 of the Advisers Act.

c. Respondents Did Not Mislead Prospective Clients Concerning Advisory Fees.

The Division claims that it was materially misleading to fail to disclose to investors that the Illustrations do not deduct advisory fees. However, the Division's Brief ignores the evidence presented demonstrating that Respondents fully disclosed the impact of advisory fees to potential investors. First, the slides specifically disclose that "there are fees and expenses associated with investing in mutual funds, including portfolio management fees and expenses and sales charges." RX 3, SEC-LA3937-00093. The seminar slides also urge attendees to "please consider the investment objectives, risks, **charges and expenses** carefully before investing." *Id.* Division investor witness Dennis Chisholm testified that he read and understood this slide. Tr. 408-09. Moreover, the unrebutted testimony is that Lucia discusses fees at the seminars. Tr. 408-09, 1199, 1285; RX 3, SEC-LA3937-00093.

Second, although Bennett admitted that all seminar attendees who later met with a RJLC adviser received full disclosure concerning all fees and transaction costs associated with the specific investments they chose, the Division's ignores this evidence.[40] Tr. 141, 157-158, 682, 1285. The BOM strategy is an asset withdrawal methodology which requires an individually customized portfolio dependent on a number of factors, including income need, assets, savings, time horizon, risk tolerance, tax bracket, investment mix, etc. Tr. 730-731. At the Hearing, the Division's counsel represented to the court that the Division is "not independently alleging that there was a failure to disclose the fees on the REITs and that that gives rise to a claim." Tr. 392. Given this position, apparently the Division's issue is not that fees weren't disclosed, but instead

[40] The Staff examined RJLC in 2003 and 2010 and did not find any deficiencies with respect to disclosure to clients of transaction fees and costs. RX 22, RX 51.

that the fees weren't disclosed during a particular 5 minute time period during the BOM seminar presentation. Again, this is a position never before articulated by the SEC or the Division. There is no reported decision or SEC guidance that even where fees are disclosed before a potential investor makes an investment decision, failure to disclose the fees at some earlier point in time is misleading.

Third, deduction of management fees was impossible because the Illustrations did not describe investments sufficiently to assign a cost or a fee. The slides at issue relate only to the BOM withdrawal strategy and do not, for example, relate to any specific investments or allocations. Tr. 572-73, 1072, 1286, 1559. It would be impossible, and therefore misleading, to deduct a fee for an undefined real estate investment or T-Bill investment. Tr. 1284. Deducting a transaction cost for an investment in the S&P 500, an index which the slides specifically disclose cannot be purchased, would have been similarly misleading. Tr. 1284; RX 3, SEC-LA3937-00161-65, 168-69, 200.

Fourth, it is interesting to compare the Division's position concerning an assumed REIT rate of return – that it was misleading to assume a reasonable rate of return – with its position that it was misleading to not assume a completely hypothetical mutual fund fee deduction. See Tr. 946, DX 70, SEC EX 016-17. Grenadier's assumptions regarding the fees deducted in Exhibits 6a-c to his Report and upon which he bases his opinion, are entirely hypothetical and the Division failed to prove Grenadier's hypothetical fees are reflective of any investment offered by RJLC. Tr. 946; DX 70.[41] As Stripe testified, "[t]here's not an actual advisory fee charged per client" instead, "there's a range of options within each individualized plan, **some of**

[41] As shown, *supra*, Grenadier's opinion regarding whether it was misleading not to deduct advisory fees relies on his interpretation of the Spreadsheets which were not created as support for the Illustrations and were never disseminated to the public. See, II.A.2., Tr. 174-75, 860.

which do not have advisory fees." Tr. 1564, see also, 1664-65. **Stripe testified that only 25% of her clients pay advisory fees.** Tr. 1564. This unrebutted evidence does not comport with Grenadier's assumptions and opinion regarding fees.

Finally, unrebutted evidence of the industry standard regarding the deduction of advisory fees or transaction costs in hypothetical illustrations using historical index rates of return and hypothetical withdrawal rates, was introduced showing that advisory fees are not deducted in such illustrations. RX 46.[42] For these reasons, Respondents decision not to deduct advisory fees in the Illustrations was not misleading to a potential investor.

d. Respondents Did Not Mislead Prospective Investors By Not Reallocating Assets in the Illustrations.

Finally, ignoring the Webinar, the Hearing testimony, and the context of the PowerPoint, the Division's Brief asserts that potential investors were misled because the Illustrations do not follow a BOM asset allocation strategy. Specifically, the Division asserts that "Respondents do not dispute that they never disclosed, in the slideshow or during seminars, that their back-tests involved placing 100% of the portfolio in stocks for the majority of the period tested." DB at 35. This assertion is not true. As is patently obvious to anyone viewing the Webinar and to all seminar attendees, BOM seminars present a continuum of information regarding the BOM strategy and, while the order of the information may not be the Division's preference, the seminar attendees heard Lucia's explanation regarding rebalancing and were not misled. Importantly, at the point in the seminar when the Illustrations are presented, Lucia has just begun to introduce the concept of the BOM withdrawal strategy. Immediately following the '66 Illustration, Lucia manually draws a sample BOM plan and discusses rebalancing at length. Tr.

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42 See also, RX 37 and DX 80.

877, 1130-32, 1624-25; RX 30, 53:24-1:10:45, DX 66, 53:2-69:5, 80:10 -81:21. At this point in the seminar, Lucia specifically discusses the BOM hypothetical illustration at year 15 and the **risks and effect of being 100% invested in stocks.** RX 30, 1:02:32 – 1:10:40, DX 66, 62:1-69:4.[43] **Lucia also specifically discusses what would happen if the stock market imploded at year 15 and what would happen if all the companies the investors were invested in stopped paying dividends in year 15.** RX 30, 1:06:24 – 1:10:40, DX 66, 62:1-69:4. The information presented at this point in the seminar – what happens at year 15 to Bucket #3 investments – is exactly what the Division asserts was omitted from the seminar and the basis for a securities violation. As this presentation was made by Lucia live and there are no accompanying PowerPoint slides, the attendees saw it, the SEC affirmatively declined to see it, and the Division ignores this segment of the seminar. Accordingly, Respondents specifically disclosed the effect of concentrating 100% of the assets in stocks for a majority of the time period and the seminar attendees were not misled.

4. RJLC Cannot Be Liable For A Violation Of Section 206(1) Because It Did Not Act With Scienter.

The foregoing demonstrates that the Division has failed to prove, by a preponderance of the evidence, that Respondents made false or misleading statements to any seminar attendee or failed to disclose material information important to making an investment decision, which precludes a finding of a Section 206 violation. Moreover, the Division's assertion that Respondents acted with a "high level of scienter" or a "high level of recklessness" requires a complete apostasy of the evidence. In order to assert that Respondents acted with scienter, the

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[43] During the 2010 Exam, the SEC examiners never asked Lucia or anyone from RJLC to explain why the Illustrations were not reallocated. Tr. 1305-06; RX 54. Had the SEC asked Lucia, he would have had the opportunity to explain that this information was specifically disclosed during the seminars.

Division ignores completely the unrebutted evidence that 1) prior to the filing of the OIP, the Respondents, the SEC and FINRA never received a single complaint from any seminar attendee asserting that he or she was misled by or had suffered any monetary loss due to a misrepresentation made at a BOM seminar. Tr. 142, 241, 671-672, 882, 1274-75, 1477-78, 1557; 2) the SEC examiners reviewed the PowerPoint presentation and the '73 Illustration in 2003 and concluded the materials were **not performance advertising and were not misleading.**[44] Tr. 1278-1281, 1485-94; RX 15, RX 16, RX 22, SEC-LA3937-1027; 3) RLJC submitted the Illustrations to two supervising broker dealers, and neither raised any concerns regarding the Illustrations.[45] Tr. 565-7, 674-76, 1034, 1053, 1077, 1305, 1691; RX 29, RX 51; 4) the representations in the Illustrations are consistent with industry standards. Tr. 837-838, 852-854, 903-904, 1093, 1147, 1269-1270, 1570-73, 1627-31; RX 46, 47, 59; and 5) as admitted by SEC examiner, Bennett, the SEC has **issued no guidance to investment advisers concerning performance advertising.** Tr. 145, 904-05, 1272-73.

Instead of addressing this exculpatory evidence, the Division contends it has met its burden of proving scienter based on: 1) an admission by Lucia that he knew using a higher rate of inflation would result in a lower ending balance in the Illustrations; 2) Lucia's admission that he did not rebucketize the Illustrations; 3) Respondents' admission that there is no documentary support for the Illustrations, 4) Respondents' admission that the Illustrations were not "back-

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[44] The 2003 examiners did not question or raise any concerns regarding the PowerPoint illustrations, including the '73 Illustration, which 1) are labeled "back-test;" 2) utilize a 3% average inflation rate for the '73 to 2003 time period; 3) utilize a 7.75% REIT rate of return; and 4) do not deduct advisory fees. DX 21, SEC-LA3937-01082-1095.

[45] In the November and December 2010 Exam Reports, the Staff faults broker dealer First Allied for not identifying the advertising issues, and states the "Staff believes an effective review by First Allied would have prevented the advertising issues" set forth in the deficiency letter. RX 50, RX 51. Respondents Exhibit 29 is Respondents' October 14, 2009 submission of the PowerPoint presentation, including the Illustrations, to First Allied Securities for Compliance Department advertising review.

tested" using the Division's definition of "back-test;" and 5) Respondents' admission that there are two errors on the '73 Illustration slide.

As demonstrated, *supra*, Lucia specifically disclosed that the actual inflation rate during the time periods of the Illustrations was higher than 3%. See, II.A.2, II.B.1; II.B.3.a. Any investor with even a rudimentary understanding of math would understand that when withdrawals are being increased by the rate of inflation, as was disclosed, a higher rate of inflation would result in higher withdrawal amounts and therefore a lower asset balance. Moreover, as demonstrated, each investor who met with a RJLC advisor received adequate disclosures regarding the effect of inflation on their investments. II.B.2. Finally, as conceded by the SEC, the purpose of the Illustrations was to compare the BOM strategy to three other non-BOM strategies. Tr. 779-780, 1154; RX 30, RX 50, LA-SEC3937-005812. Moreover, in the Staff's 2010 Exam Report, the Staff "notes that substituting actual inflation rates would also result in the non-Buckets of Money portfolios *failing* even more quickly than they did in the presentation." RX 50 LA-SEC3937-005792 (emphasis in original). The fact that Lucia advised the seminar attendees that the actual inflation rate for the time period was higher than 3% obviates a finding of scienter.

Regarding a failure to "rebucketize," the Division's Brief asserts that Respondents' lack of candor to the seminar attendees regarding how they achieved the results in the Illustrations without rebucketizing is strong evidence of an intent to deceive. As shown, *supra*, the Webinar is conclusive, unrebutted evidence that Lucia specifically discusses how the results are achieved without reallocating in the final manually drawn hypothetical illustration. II.B.3.d. During the BOM seminars, Lucia specifically demonstrates the effect of being 100% invested in stocks in year 15 of the implementation of a BOM plan, and specifically describes the effect of a stock

market crash and the implications of companies ceasing to pay dividends at year 15. RX 30, 53:24-1:10:45, DX 66, 53:2-69:5. The fact that the Staff did not attend a seminar and the Division ignores the disclosures made in the Webinar cannot provide a basis for finding scienter.

Regarding a lack of documentation to support the Illustrations, there is no requirement that Respondents maintain records where the calculations do not demonstrate the performance or rate of return of a managed account or securities recommendation. See, II.A. While for purposes of this proceeding, the Division wishes Rule 204-2(a)(16) was worded differently, it is not. If the SEC wants to change the law, it should do so, but the Division cannot not use this proceeding to legislate a new requirement. See, *Christopher v. Smithkline Beecham Corp.* 567 U.S. ___, 132 S. Ct. 2156, 2168 (2012)("**[i]t is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or be held liable when the agency announces its interpretations for the first time in an enforcement proceeding and demands deference.**").

Regarding the Division's assertion that Respondents' lack of candor is demonstrated by the use of the term "back-test" in the Illustrations, as shown, *supra*, since the 2010 examination fieldwork, Respondents have consistently taken the position that the Illustrations were not "back-tests" applying the Division's not heretofore announced definition of a "back-test." See, II.B.1. Instead, the Respondents utilized the term consistent with the definition used within the retirement planning industry and sanctioned by the 2003 SEC examiners and RJLC's supervising broker dealers who reviewed the PowerPoint for compliance purposes. *Id.* Respondents' position has been consistent and in no way establishes a lack of candor.

Regarding the two errors on the '73 Illustration – which the Division describes as being "riddled" with errors – Respondents volunteered that the slide contained the errors and the OIP does not contain any allegations concerning these errors. The Division was made aware of one error, a mathematical error relating to the increase in income (withdrawal) for years '91-'94, when Respondents' expert **volunteered** the existence of the error. Tr. 1427-28; RX 3 SEC-LA3937-00200, RX 35. The amount stated on the slide as the withdrawal rate for years 1991-1994 is $96,000, but should have been $102,092. RX 3 SEC-LA3937-00200, RX 35, Appendix 4 to Hekman Report. Hekman's Report, which identified the error, was produced to the Division on October 5, 2012 and Hekman testified during his October 26, 2012 deposition regarding the existence of the error. Tr. 1427-28, RX 35. During his deposition, Hekman testified that Lucia admitted to this error prior to Hekman's preparation of his Report. Tr. 1427-28. Ochs admitted to the existence of this error during her testimony Tr. 667.[46] Lucia admitted to this error multiple times during his testimony. Tr. 1080-81.[47] Plum testified that during his investigative testimony, the Division never asked him who had performed the mathematical calculations for the Illustrations. Tr. 889. The Division did not rebut or attempt to impeach this testimony.[48] This

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[46] The Division's misquotes Ochs as testifying that Respondents did not have any procedure for checking the accuracy of the slides used in the seminars. DB, p. 38. Ochs testimony is that RJLC did not have any procedures in place to make sure that the slides "did not contain numerical errors." Tr. 668. Given the fact that neither the Division nor its six figure expert caught this error, it appears the Division and Grenadier also did not have procedures in place to find numerical errors.

[47] The Division asserts that Lucia "resisted" admitting there was an error. DB, p. 38. This is not true. Lucia admitted to the error 4 times in less than two transcript pages and never "resisted" admitting to this error. Tr. 1080-81.

[48] Although the Division attempts to malign Plum for "revealing" during his Hearing testimony that former RJLC employee, Brian Johnson may have performed the mathematical calculations for the Illustrations, during its investigation, the Division **never asked Plum or Lucia** (the only individuals from whom investigative testimony was taken) who did the math for the Illustrations. DB, p. 13, fn. 3. Given that the majority of the Division's questioning during the Hearing consisted of re-asking investigative testimony questions, if there was investigative

unrebutted testimony demonstrates that prior to the Hearing, the Division was made aware through Respondents' expert that the '73 Illustration contained a mathematical error and that Lucia admitted to the error. There is no evidence that Respondents made any effort to conceal the existence of this error. It is difficult to imagine a situation where more candor was shown regarding the existence and discovery of a mathematical error.

The second possible error, the existence of which was **volunteered** by Plum during his Hearing testimony, is a potential error in the disclosure language on the '73 Illustration slide. The disclosure states, "[t]his example uses actual . . . S&P 500 returns to calculate growth returns." RX 3, SEC-LA3937-0200. Plum testified that instead of using the actual historical S&P 500 returns, the '73 Illustration may have used actual S&P 500 returns for 1973 and 1974, and an average 10% return for the remainder of the time period. Tr. 785-788. Plum testified that the disclosure may be incorrect because the inputs for the '73 Illustration were meant to replicate and be consistent with the inputs for the other withdrawal strategies. Tr. 786. While the Division attempts to make much of this error, **no evidence was presented that this error rendered the '73 Illustration materially misleading.** Indeed, the evidence is that the error understated the ending balance of the BOM strategy on the '73 Illustration. In the December 2010 Exam Report, the Staff states that the ending balance presented for the BOM withdrawal strategy in the '73

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testimony to the contrary, presumably the Division would have used that testimony to impeach Plum. Footnote 10 to the Division's Brief states, **without citation**, "During the 2010 examination and throughout the Division's investigation, Respondents stated Plum had prepared the 1973 calculations supporting the 'BOM' slide." This is not true - as borne out by the Division's lack of citation. Respondents should not be blamed for the Division's decision to conduct an investigation that was more focused on selective prosecution than truth seeking.

Illustration was "was substantially lower than the staff's recalculation based on the **hypothetical scenario . . .**" RX 50, LA-SEC3937-005800, fn. 11.[49]

Finally, the Division maintains that Respondents' failure to conduct its own investigation as to the accuracy of the challenged Illustrations after receipt of the December 2010 deficiency letter "supports a finding of an intent to deceive." DB, p. 38. In addition to the Division's apparent misconception that Respondents have any duty to assist the Division in its investigation, this assertion ignores the fact that upon receipt of the deficiency letter, Respondents' first notice that the SEC considered the Illustrations misleading, Respondents **immediately ceased use of the Illustrations**. Tr. 1277-1278; RX 6 SEC-LA3937-03648-49, RX 8, p. 5. Since the Respondents were not challenging the Division's demand that they cease using the Illustrations – and never have – there was no reason for Respondents to investigate the slides and certainly no "intent to deceive" that can be ascribed to Respondents' conduct. Again, contrary to the Division's assertion that the two errors are evidence of scienter for lack of candor, the fact that Respondents volunteered the existence of the errors after the Division and its expert failed to identify the errors evinces the frankness and integrity of Respondents.

With respect to legal precedent, the Division's Brief makes no attempt to address *SEC v. Slocum*, 334 F. Supp.2d 144 (D.R.I. 2004), which is on point and provides authoritative support for a finding that Respondents did not act with the requisite scienter. In *Slocum*, the SEC conducted an examination of the registrant which failed to note any deficiency in registrant's account structure. *Id.* at 181. Six years later, the SEC conducted a subsequent examination

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[49] The actual average returns for the S&P 500 for January 1, 1975 to December 31, 1994 were 15.49% and the annualized return for the same period is 14.68%. DX 11. The Division did not attempt to demonstrate the error resulted in materially misleading representations because the ending balance for the BOM withdrawal strategy would have been higher had actual S&P returns been utilized instead of an average 10% return.

resulting in alleged violations as to registrant's account structure. *Id.* The *Slocum* court found that the registrant's reliance on the SEC's prior evaluation was reasonable and, as a result, the SEC failed to meet is burden to prove scienter. *Id.* at 182. Although the Division ignores the impact of the determinations of SEC in connection with the 2003 examination of RJLC, this is contrary to the law. The *Slocum* court also found no scienter on the grounds that during the relevant time period, the registrant was subject to external examinations from its independent auditors. *Id.* at 185. The fact that Respondents submitted the Illustrations to its supervising broker dealers for compliance review is analogous. *Slocum* provides this Court with the requisite authority to dismiss the scienter based allegations as well as the aiding and abetting claim.

When considering the authoritative body of scienter based decisions, including the three scienter cases cited by the Division,[50] which are readily distinguishable and do not provide support for a finding of scienter, the facts here stand out as an aberration. Here, there is no evidence any investor suffered a loss or complained, or that there was a single "red flag" alerting Respondents to a possible securities violation until receipt of the deficiency letter.[51] The Division presented no evidence that Respondents were aware or reckless in not knowing that a potential investor might be misled, particularly given the unrebutted evidence that every investor was advised of the requisite disclosures prior to making an investment with RJLC, and, as soon

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[50] In *In the Matter of Monetta Financial Services, Inc.*, 2000 SEC LEXIS 574 (2000), the AJL found lack of candor and scienter where, among other actions to conceal his behavior, the **adviser "lied" to the SEC examiners.** *Id.* at *63. In *In the Matter of G. Bradley Taylor*, 2002 SEC LEXIS 2429 (2002), the ALJ found scienter where the respondent **concealed** his brokerage account transactions by transferring shares to his mother's account and by **failing to disclose** he was being compensated to promote certain stocks. *Id.* at *35. In *Vernazza v. SEC*, 327 F.3d 851 (9th Cir. 2003), respondents **made false representations to clients that they had no financial interest in and received no commissions for recommending certain funds.**

[51] Even the Los Angeles Regional Office, including the Associate Regional Director, did not initially think the deficiencies merited an enforcement referral. The mystery of the change in position was never explained. RX 50, RX 51.

as the SEC brought it to Respondents' attention that it had changed its position from the 2003 Exam determination that the PowerPoint was not misleading, Respondents immediately ceased using the Illustrations. Tr. 1276-1281. Accordingly, the Division has failed to meet its burden to prove scienter.

5. The Division Has Failed To Prove RJLC Acted Negligently.

To establish a violation of Section 206(2), the Division must show that Respondents failed to disclose or omitted material facts in their dealings with potential clients. Recognizing that liability under Section 206(2) can be predicated on negligence, the Division has not met its burden of proof. Negligence is the failure to exercise reasonable care. *IFG Network Sec., Inc.*, 88 SEC Docket 1374, 1389 (July 11, 2006). The reasonable care Respondents exercised is demonstrated by the unrebutted evidence that the PowerPoint and the '73 Illustrations were submitted to the 2003 SEC examiners for review and the examiners communicated no concern regarding the PowerPoint. Tr. 1278-1281, 1485-94; RX 15, RX 16, RX 22, SEC-LA3937-1027. Respondents also submitted the PowerPoint and the Illustrations to their supervising broker dealers, Securities America and First Allied Securities, for review. Tr. 565-7, 674-76, 1034, 1053, 1077, 1305, 1691; RX 29, RX 51. The SEC's November 2010 Exam Report acknowledges that RJLC's compliance manual states:

> Advertising materials will not contain any untrue statements of material facts or any advertisement that is false or misleading. All advertising material will be submitted to [First Allied Securities'] Compliance/Supervision department for review and approval prior to use. **FAS's Compliance/Supervision department personnel will have discretion over approval of RJLC's advertising or marketing materials** according to the requirements established by FAS and disclosed in FAS's Compliance Manual.

The 2010 Exam Report also states:

> The examination disclosed that RJLC submitted the [Illustrations] to First Allied for review and approval. **However, it appears that First Allied did not test the**

> **accuracy of any performance returns presented in the marketing materials, and the First Allied review did not identify any of the marketing issues discussed above. The staff believes that an effective review of the marketing materials and the performance returns presented therein could have prevented the advertising issues . . . .**" EX 50 LA-SEC3937-005798.

This acknowledgment by the Staff, that First Allied failed to identify the advertising issues the SEC complains of, is unrebutted evidence that Lucia exercised due care concerning submission of the Illustration's for compliance review. Respondents were not negligent or asleep at the wheel. Instead, they appropriately relied on the 2003 SEC examination and their supervising broker dealers' compliance reviews for comfort that the Illustrations were not misleading.

As Lucia testified, "**[i]f the [2003 SEC examiners] would have told me that they had an objection to this slide, if the broker dealer who approved the presentation would have had an objection to this slide, if my internal compliance department had an objection with this slide, I would have pulled it immediately and never used it again.**" Tr. 1281.

C. **The Division Has Failed To Establish A Violation Of Section 206(4)-1.**

Rule 206(4)-1 is the principal rule by which the Commission regulates advertisements under the Advisers Act. Rule 206(4)-1 contains four specific prohibitions and one catchall provision. 17 C.F.R. § 275.206(4)-1. Specifically, Rule 206(4)-1(a)(5) makes it a violation of Section 206(4) for an investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of material fact or which is otherwise false or misleading.

Notwithstanding the fact that the 2003 examination Staff determined that RJLC was not engaged in performance advertising, the OIP and the Division assert that the Illustrations are performance advertising violations under 17 C.F.R. § 275.206(4)-1(a)(5). DB, p. 42, OIP ¶ 28.[52]

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[52] The Division's Brief does not acknowledge or address the fact that after reviewing the seminar slide presentation in 2003 and being aware of the BOM seminars, the SEC examiners determined that RJLC was not engaged in performance advertising. Tr. 178-79; RX 22, SEC-

Although the Division attempts deceptively to characterize the Illustrations as performance advertising by unsuccessfully seeking to elicit testimony that an investor could "buy" the BOM strategy, this position is unavailing. Tr. 1151-1153, see also, II.E. Notably, while the Division has asserted a performance advertising violation against Respondents, the Division's Brief does not cite to a single authority where the performance advertisement at issue was a hypothetical unrelated or without any reference to a managed account, client account or specific securities recommendation or transaction.

In support of its performance advertising claim, the Division cites to two cases, three settlements and a no-action letter, none of which are applicable here. In *Valicenti Advisory Services, Inc. v. SEC*, 198 F.3d 62 (2nd Cir. 1999), the advertising materials distributed contained a chart showing respondents' rate of return on **its clients' investment portfolio.** The chart indicated that the figures represented a "composite of discretionary accounts" which are "those accounts over which [respondent] exercised full discretionary authority because the clients had placed no restrictions on their management." *Id.* at 63. In *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101 (9th Cir. 1977), the respondents published a weekly market letter which made "**recommendations with respect to the stock of selected corporations.**" *Id.* at 1104. Moreover, the *Richmond* court found performance advertising violations where "specific past recommendations" were included in the marketing materials "without offering a complete list of recommendations made during the previous year," and the distinguishable fact that "recommendations appear . . . in the Model Portfolio, a regular feature that **describes transactions in various stocks.**" *Id.* at 1106. Finally, the "examples of successful use of

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LA3937-1027. The Division's Brief also does not address the unrebutted evidence that the SEC has provided no guidance to investment advisers regarding permissible or impermissible performance advertising, and therefore this proceeding violates Respondents' due process right. Tr. 145.

Richmond's techniques were given in the book without disclosing that the examples were hypotheticals and **used unlawful borrowing techniques.**" *Id.* The fact patterns and findings of *Valicenti* and *Richmond* are clearly distinguishable as the type of "performance advertising" contemplated by the Rule, as opposed to the Illustrations which demonstrated to seminar attendees something altogether different, the superiority of withdrawing safe assets instead of risky assets during retirement.

Apart from their "dubious value as precedent,"[53] the settlement orders cited in the Division's Brief further amplify that there is no other instance where the Division has brought a Rule 206(4)-1(a)(5) proceeding based on a retirement withdrawal strategy which does not identify any actual trading or any purported performance by any client account or in any specific investment. In *In Re LBS Capital Management, Inc.*, Advisers Act Release No. 1644 (July 18, 1977), the advertisement was found to be materially misleading performance advertising because it failed to disclose that the performance results of the mutual fund timing service did not represent the results of **actual trading in client accounts.** In *In the Matter of William J. Ferry,* Advisers Act Release No. 1747 (August 19, 1998), the graphs at issue failed to disclose that the advisers' **clients actual results were materially lower** than the advertised results. In *In the Matter of Meridian Investment Management Corp., et al.*, Adviser Release No. 1779 (December 28, 1998), the advertisements at issue made misleading representations or omissions concerning the performance of **client accounts.**

Finally, the Division relies on an almost 30-year old no-action letter, *Clover Capital Management, Inc.*, 1986 WL 67379 (SEC No Action Letter Oct. 28, 1986) to assert a performance advertising violation. As addressed in Respondents' Post-Hearing Brief, *Clover* is

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53 *In the Matter of FXC Investors Corp. et al.*, Initial Decision Release No. 218 (December 9, 2002), 2002 WL 31741561, *10-11.

not binding on the courts and does not warrant judicial deference. See, *FXC Investors, supra,* *10-11. More importantly, the Illustrations and the BOM withdrawal strategy are not model portfolios. Tr. 571, 682, 730, 878, 883, 1282. Indeed, as defined by *Clover*, the asset-types for each BOM bucket are too general, i.e. direct ownership in real estate or REITs, stocks, T-Bills, etc. The Illustrations do not specify a type of bond, any particular stock, an identifiable REIT or real estate investment, or an institution's certificate of deposit – all particulars required to make these Illustrations fit within the performance advertising category. Tr. 142, 571-72, 1274, 1281, 1284, 1594, 1597; RX 3, SEC-LA3937-00199-211. Indeed, both Illustrations include the S&P 500, an index, which, as disclosed to seminar attendees, is not something that can even be purchased by investors. RX 3, SEC-LA3937-00161-65, 168-69, 200. No reasonable investor could have walked away from the BOM seminars believing he or she had just reviewed a model portfolio. More importantly, **no investor could have walked away from BOM seminar having made a decision, or even influenced as to a decision, to invest in any security.**[54] Therefore, *Clover* does not provide a legal basis for finding Respondents violated Rule 206(4)-1(a)(5).

Moreover, even if *Clover* were applicable here, *Clover's* mandate to consider the "total context" of the advertisement has been systematically disregarded by the Staff and the Division. *Clover, supra,* at fn. 3. Throughout the 2010 Exam, the Division's investigation and the Hearing, the examiners and the Division intentionally refused to acknowledge that the PowerPoint was a back drop for Lucia's oral presentation and other aspects of the BOM seminars. There was never a point in time when a potential investor saw the PowerPoint without hearing Lucia's narration and seeing Lucia manually illustrate the complete BOM plan. Did the

[54] The unrebutted evidence is that no attendee ever requested that their BOM plan replicate the Illustrations. Tr. 1558-59, 1631-32.

examiners simply assume that Lucia clicked through the PowerPoint without providing any explanation or clarifying statements? If that were the case, why would Lucia have bothered with the expense of a seminar? Instead, he could easily have posted the PowerPoint on the website if no explanation was required.

The pertinent question is **why did the examiners and the Division[55] consider the PowerPoint in a vacuum without any interest in what information was conveyed to the seminar attendees?** Bennett had ample opportunity between February and December of 2010 to attend a BOM seminar and declined to do so. Tr. 148. The November 2010 Exam Report specifically notes that, "**for the period April 15, 2010 through June 5, 2010, Registrant was scheduled to host nine seminars in eight different cities (. . . San Diego . . . Newport Beach, California . . . San Joe, California).** RX 50, LA-SEC3937-005788. Fully aware that any discrepancies regarding what the examiners thought might have been conveyed to the seminar attendees versus what representations were actually made, could have been cleared up simply by attending a local BOM seminar. Inexplicably, the examiners refused. Further, **Bennett never asked Lucia what information he conveyed to seminar attendees.** Tr. 1223. It is beyond the pale that the Division would accuse Lucia of misleading investors, including a September 5, 2012 press release entitled, "*SEC Charges Radio Personality for Conducting Misleading Investment Seminars*" and subsequent statement that Lucia spread "misleading information about his "Buckets of Money" strategy at a series of investment seminars," when the SEC and the Division never even asked Lucia what information was conveyed to the attendees. Instead, the

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55 Given that the examiners waited until December 17, 2010, nine months after the field work, to send Respondents a deficiency letter and the Division obtained the Formal Order of Investigation on December 2, 2010, it is perplexing that as part of the Division's investigation, it would not make any effort to see and hear what the seminar attendees did. Such conduct indicates the Division was less interested in protecting the investing public than selectively prosecuting Respondents.

Division filed an OIP that decimated Respondents' business, wreaked havoc among RJLC's retiree clients and permanently tarnished Lucia's otherwise stellar professional reputation. As shown in Respondents' Post Hearing Brief, the Webinar conclusively demonstrates that the Illustrations are not performance advertising. Accordingly, the Section 206(4)-1 claim should be dismissed.

D. The Division Cannot Establish That Lucia Willfully Aided And Abetted RJLC In Violating Section 206(1), (2) Or (4) Of The Advisers Act.

In a dismissive fashion, the Division asserts that it has proven that Lucia aided and abetted RJLC's violations of the Investors Act. However, to make this argument, the Division disregards the substantial unrebutted evidence that the "violations" are based entirely on the SEC examiners doing a complete about face as to whether the Illustrations are misleading, and a conclusion that they are based on a standard that has never before been articulated by the Commission. The Division's latest argument, that even though Respondents **volunteered** the existence of two errors, **which the Division made no attempt to prove were materially misleading**, Lucia aided and abetted the violation by not conducting the Division's investigation for it. At what point in time did it become a requirement for a registrant - who the SEC examiners never bothered to even ask about the Illustrations –to conduct his own investigation as to marketing materials he had ceased using, then provide the Division with the results of that investigation? This is not and has never been the aiding and abetting standard. Indeed, the fact that the Division would even assert this argument is troubling.

"If the conduct is allegedly improper under the secondary liability theory of aiding and abetting, the protective function mentioned in *Investors Research Corp. v. SEC*, 628 F.2d 168 (D.C. Cir. 1980), becomes applicable and an awareness of wrongdoing must be established."

Deckler v. SEC, 631 F.2d 1380, 1388 (10th Cir. 1980). Simply put, the Division has failed to prove a securities violation by RJLC and also failed to prove that Lucia was reckless or had actual "knowledge" of a wrongdoing . See, *supra*, II.B.4. Further, "economic motivation is too remote and minimal to demonstrate a conscious intent." *SEC v. Tambone*, 417 F. Supp.2d 127 (D. Mass. 2006) citing *Austin v. Bradley, Barry & Tarlow, P.C.*, 836 F. Supp. 36, 39 (D. Mass. 1993).

As shown above, the Division has failed to prove Lucia was or should have been aware that presenting the Illustrations was aiding any wrongdoing where the SEC reviewed the '73 Illustration in 2003 and did not raise any red flags that it was misleading; no RJLC investor ever complained about the Illustrations and no investor is alleged to have suffered any monetary loss as a result of a seminar; the Illustrations were submitted to multiple layers of compliance; the SEC offered no guidance as to performance advertising; and the Division's definition of "back-test" is a substantial change in SEC policy that has never been communicated to investment advisers. See, *supra*; III.A-D; *Slocum, supra,* at 334 F. Supp.2d 185. The evidence also demonstrates that when the SEC examiners informed Lucia of a potential violation, he voluntarily took every step possible to rectify the situation as quickly as possible by pulling the Illustrations from the PowerPoint and ceasing sales and distribution of his books including *The Buckets of Money Retirement Solution: The Ultimate Guide to Income for Life* (2010) which was not cited by the examiners. Tr. 1275-77. Thus, no aiding and abetting has been or can be established.

E. The Division Presented No Evidence That Respondents Earned "Substantial" Monies From The Seminars.

Perhaps the most preposterous argument in the Division's Brief is that it "introduced evidence that Lucia earned substantial fees, commissions, and other compensation derived from customers who attended the BOM seminars." DB, p. 25. The Division offered **no evidence that linked directly or indirectly any monetary amount Respondents earned to any seminar attendee.** The only evidence regarding any monies Lucia earned as a result of the seminars is a $10 per lead flat fee paid by RJLWM to Lucia. Tr. 588-591; RX 24.[56] However, the Division made **no attempt to quantify this amount.** Tr. 588-591. Stripe testified that approximately 30% of her clients became RJLC clients after attending a seminar, 20% as a result of Lucia's radio show and 50% from client referrals or personal relationships. Tr. 1557-58. Stripe also testified that 50% of her clients have invested in REITs and only 25% of her clients pay advisory fees. Tr. 1564, 1597. This is the only evidence concerning the numbers of seminar attendees who became RJLC clients, and the Division has failed to prove by a preponderance of the evidence that Lucia received any commission, fee and other compensation from any "seminar attendee."

The Division asserts that "commissions were paid to Lucia because persons who attended the seminars were **buying the BOM strategy** and not the underlying products . . . ." DB, p. 25. Although finally acknowledging that a seminar attendee could not "buy" the generally described assets that fill the buckets, i.e. bonds, direct ownership in real estate, S&P 500 index, the Division desperately clings to the notion that a seminar attendee could "buy" the BOM strategy as a means to connect the "commissions" to a seminar attendee. DB, p. 25. This position, which

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[56] Bennett testified that the SEC did not raise any deficiencies concerning Lucia's compensation. Tr. 105; RX 51.

the Division manufactured out of whole cloth after Bennett admitted the Illustrations did not recommend any security or demonstrate the performance of any managed account, is meritless. While the Division is quick to assert a seminar attendee could "buy" the BOM strategy, it never explains, and certainly presents no evidence as to what an attendee was "buying." Ochs testified that that the BOM strategy is "not something you can sell." Tr. 572, 609. Lucia testified that he wasn't "selling" the BOM strategy -- or anything else – at the BOM seminars. Tr. 1281. The Division's assertion that seminar attendees "bought" the BOM strategy has not and cannot be proven. **The ramifications of the Division's position, that the mere presentation of an investment strategy that does not promote or recommend the sale of any security or managed account is investment advice requiring all those who advocate such a strategy to register as investment advisers, would have radical, and perhaps uncontemplated consequences.**[57] The challenge for the Division by pursuing this novel, but baseless, theory is that it creates even stronger grounds for this court to find that Respondents' due process rights have been violated. At what point has the Commission given fair notice to investment advisers that a retirement planning withdrawal strategy, that is not comprised of any underlying products that can be purchased, is a vehicle for alleging an investment adviser received compensation even where the adviser has no communication with the investor as to the investments purchased? *FCC v. Fox Television Stations, Inc.* 567 U.S. ___, No. 10-1293 (June 21, 2012); *Christopher v. Smithkline Beecham Corp.* 567 U.S. ___, 132 S. Ct. 2156 (2012). With each new violation premise proposed by the Division, we seem to slipping further into a constitutional abyss.

Finally, the Division points to the assertion that Lucia "received $8.7 million in commissions from the sale of non-traded REITs in calendar year 2009" as an example of the

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[57] For example, would finance professors who teach investment strategies and whose students pay to attend their classes be retired to register as investment advisers?

"substantial" amounts generated from the seminars. DB, 25. REITs. First, the Division did not even attempt to introduce any evidence that this amount was in any way a direct or indirect result of the presentation of the Illustrations or that any of this amount was received from the purchase of a REIT by a seminar attendee.

Second, the Division's blatant distortion of the facts and regulations regarding REITs is telling. As referenced on the Commission's website, "[Investors] can purchase shares of a non-traded REIT **through a broker** that has been engaged to participate in the non-traded REIT's offering." http://www.sec.gov/answers/reits.htm. As Lucia, Jr. testified in response to the Division's questioning:

> Q. And am I correct that the Raymond J. Lucia Companies, Inc. sold REITs that resulted in a payment of commissions?
> A. No. Raymond J. Lucia Companies is a Registered Investment Adviser. **Raymond J. Lucia Companies does not sell REITS.** Our investment adviser representatives [such as Stripe], **as affiliated with the securities broker** [First Allied], would sell -- potentially sell non-traded REITS and receive a commission. . . . .
> And the amount of that [REIT] commission is set by the product [REIT] sponsor and then the dollar amount that gets passed through to the representative, . . . **would be determined by the broker dealer.** Tr. 1652-53.

Lucia, Jr. also testified that the REIT commission payments due to the investment adviser representatives were initially paid to Lucia because the advisers are salaried. Tr. 1696. Lucia then paid the firm overhead expenses, including the advisers' salaries and bonuses, staff salaries, rents for 15 offices, advertising and travel. Tr. 1073, 1304, 1696. Lucia testified that from the $8.7 million "gross" amount referenced in the 2010 Exam Report, the net amount, after expenses, was "far closer to zero than it is to $8 million." Tr. 1304. In response to questioning by this Court, Lucia also testified that it is "absolutely, unequivocally false" to contend that he "made" $10 million dollars. Tr. 1346-49. Lucia also testified that in 2009, he didn't make any

money for the sale of non-traded REITs. Tr. 1348-49. As shown, the Division did not prove that RJLC or Lucia personally **netted any amount from REIT commission payments from seminar attendees, existing clients, referrals or otherwise.**

III. ASSESSMENT OF PENALTIES

Because the Division has failed to prove the violations alleged in the OIP, no disciplinary sanctions are warranted. Further, the fact that the Commission has failed to issue any guidance with regard to performance advertising or the Division's definition of "back-test" is a violation of Respondents' due process rights and this court should not defer to the Division's interpretation where, as here, it will penalize Respondents who have not received fair notice of a regulatory violation. *FCC v. Fox Television Stations, Inc.* 567 U.S. ___, No. 10-1293 (June 21, 2012); *Christopher v. Smithkline Beecham Corp.* 567 U.S. ___, 132 S. Ct. 2156 (2012); *Upton v. SEC*, 75 F.3d 92 (2nd Cir. 1996); *WHX Corp. v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004).

In a case that unfortunately turns in large part on semantics, the Division seeks the equivalent of a professional death penalty against Respondents. The Division requests that the Court revoke Respondents' registration as investment advisers, bar them from association with any registered investment adviser or broker-dealer, impose third tier civil penalties amounting to nearly $1 million,[58] issue a cease and desist order, and require Lucia to disclose at any future seminar that he has been sanctioned for providing "misleading performance data" about BOM.[59]

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[58] Given the magnitude of the penalties and sanctions sought, Respondents' right to a jury trial was violated. *Southern Union Co. v. United States*, No. 11-94 (Sup. Ct. June 21, 2012).

[59] To be clear, the Division is asking this court to invoke an interpretation of Sections 206(1), (2), and (4) and 204-2(a)(16) to impose massive sanctions where the interpretation the Division urges has never been announced to investment advisers. The Commission has never announced that the type of information in the Illustrations would be considered "performance advertising."

This is an exemplar of prosecutorial overreach typified by the lack of evidence supporting an egregious securities violation, any investor losses, or scienter.

The conceit of the Division's position, particularly in light of the fact that in 2003, the SEC examiners put their agency's imprimatur on the very same slides the Division has used to virtually destroy Respondents, is profound. If the Division had told Lucia in 2003 that the '73 Illustration or any aspect of the PowerPoint was misleading, Lucia would have ceased using the slides immediately. Tr. 1277, 1281. If the SEC examiners had troubled to ask Lucia a single question about the PowerPoint, the seminars or the Illustrations, he could have explained to the Division that the information the examiners **presumed** was not disclosed, had in fact been disclosed during the seminar and afterwards when a potential investor met with an advisor. Similarly, if the SEC examiners or the Division had attended a BOM seminar, they would have been able to consider the context of the Illustrations and seen that the seminar attendees were not misled.

Moreover, as demonstrated by the 2010 Exam Report, in November 2010 Bennett, and the Los Angeles Regional Office's Branch Chief, Assistant Regional Director and the Associate Regional Director all signed and dated the 2010 Exam Report **concluding that the examination did not even warrant an enforcement referral.** RX 50, LA-SEC3937-005780. How Respondents' alleged conduct escalates from a deficiency letter resolution to penalties that will end Lucia's 38 year discipline free career appears to be attributable solely to Respondents' temerity to defend themselves. For the reasons set forth above, the Division has not proven scienter, has not proven a violation of Sections 206 or 204 of the Advisers Act, and has not proven the factors necessary to impose disciplinary sanctions.

The factors considered when imposing disciplinary sanctions are: (1) the egregiousness of the respondent's actions, (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979). The evidence presented by the Division fails to shift any of these factors in favor of the penalties sought, or any penalties.

The Division spent considerable time simply trying, and failing, to establish that a misrepresentation occurred at the seminars, and certainly never proved that any purported misrepresentation was egregious. Although the Division's Brief is silent as to the unrebutted evidence presented by Respondents, it cannot be ignored that: 1) of the 50,000 "reasonable investors" who attended a BOM seminar, not a single person contended that he or she was misled or asserted that he or she had lost a dime as a result of the Illustrations; 2) every seminar attendee who met with a RJLC advisor received appropriate and adequate disclosures concerning inflation rates, REIT rates and fees, advisory fees and portfolio allocation; 3) during the seminar, Lucia specially addressed the fact that at the end of 15 years, the illustrations were 100% invested in stocks, and the effect on those investments in the case of a stock market collapse or cessation of dividends payments; and 4) the Respondents used an assumed inflation rate of 3%, and the fact that it was assumed and was lower than the actual inflation rate during the time period referenced in the Illustrations was specifically disclosed to the seminar attendees; and 5) the Division made no effort to offer any evidence that Respondents obtained any pecuniary gain linked to the Illustrations. Of the purported misrepresentations at issue, the evidence proves that the representations were either accurate or, at worst, subject to dispute by financial professionals.

On each issue, this case has been fought in the gray area where hypothetical and historical economic data intersect. Finally, to conclusively demonstrate that the SEC did not consider Respondents' conduct egregious one need look no further than the lack of immediacy with which the Staff proceeded against Respondents. If the Staff had reached the conclusion during the 2010 Exam that the conduct was egregious and potential investors were being misled by the thousands at BOM seminars, it is revealing from a penalty perspective that the Staff allowed Lucia to continue presenting the Illustrations at seminars for ten months before demanding that RJLC cease dissemination.

With respect to the second factor, the isolated or recurrent nature of the infraction, again the audacity of the Division to complain as to the duration of time the Illustrations were presented and the number of potential investors who saw the slides is astounding. If the SEC examiners had advised Respondents during the 2003 Exam that the '73 Illustration or the PowerPoint was misleading, presentation of the '73 Illustration would have ceased in 2003 and the '66 Illustration would never have been shown to potential investors.

With respect to the third factor relating degree of scienter, as shown, *supra*, the Division has failed to prove scienter and ignores the substantial unrebutted evidence offered by Respondents that 1) no seminar attendee ever complained or sustained any monetary loss; 2) the SEC reviewed the PowerPoint presentation in 2003 and determined the slides were not performance advertising and failed to express even a modicum of concern as to the '73 Illustration; 3) the Illustrations were submitted for compliance review to two supervising broker dealers and no issues were raised; 4) the representations in the Illustrations and the use of the term "back-test" are consistent with industry standards; and 5) the SEC has issued no guidance to

investment advisers concerning the definition of "back-test" proffered by the Division for the first time in the OIP, and no guidance concerning performance advertising.

The evidence has shown that the 2003 Exam had a profound effect on Respondents' belief that the Illustrations were unobjectionable. This is in line with cases that have found that a respondent's prior interactions and communications with the Commission, particularly in an examination setting, can have an outsized influence on a respondent's state of mind and in shaping its good faith belief that its actions are legal and permissible. See e.g., *SEC v. Slocum, Gordon, Co.*, 334 F. Supp. 2d 144, 147 (D. R.I. 2004).

The Division's evidence is limited to proof that Respondents knew that the actual average inflation rate for the Illustration time period was higher than 3%. However, Lucia explicitly disclosed this fact in the seminars as evinced by the Webinar statement "we all know [the inflation rate] was higher, but we wouldn't have known that at the time." Tr. 777, 963, 1138, 1146, 1547, 1686, RX 30, 48:10, DX 66, 48:21-49:2. Thus, the only arguably understated assumption was an inflation rate that was disclosed as hypothetical and understated at the time the representation was made. Can the Division truly contend that this is the act of a person trying to intentionally deceive others as to the actual inflation rate in the 60's and 70s? Common sense would dictate that it should not.

As to the fourth factor, assurances against future violations, upon receipt of the deficiency letter, RJLC advised the Staff that the Illustrations had been removed from the PowerPoint and distribution of Lucia's books had ceased. Tr. 1275-1277, RX 7, p. 8 and RX 8, p. 2. Given the devastating effect this proceeding has had on Lucia's business, he has no intention of ever using the term "back-tested" again. Further, as shown at the Hearing, the Illustrations are insignificant to the BOM presentation which is borne out by the fact that after

RJLC ceased using the Illustrations, the response rate of seminar attendees who filled out a response card to meet with an RJLC advisor did not decline. Tr. 1276-1278, 1633-34.

The Division asserts that Respondents' assurances that they have stopped the violative conduct should be given "no weight" because certain advertising claims by Respondents regarding the duration of RJLC's business, which were pointed out in the SEC's 2003 examination deficiency letter, were not corrected and were cited as deficiencies in the 2010 deficiency letter. Respondents admitted that the representations regarding length of time in business were technically inaccurate because although Lucia had a 23 year history as an investment adviser, RJLC had not been incorporated for 23 years. Tr. 1213-15, RX 7, pg. 9. Upon receipt of the December 2010 deficiency letter, Respondents advised the Staff that, "the referenced marketing materials are no longer being disseminated and the website section and video segments have been deleted." *Id.* The Division offered no evidence that in the past two years, Respondents have made any misleading statements concerning the duration of RJLC's business or any other recidivist violations. This can hardly be the basis for imposition of the draconian sanctions the Division seeks.

As to the fifth factor, Respondents' recognition of the wrongful nature of his conduct, the Division asserts that Respondents' lack of candor is demonstrated by efforts during the Hearing to recharacterize "back-testing" claims as "forward looking." If so, how does the Division explain Bennett's testimony and 2010 Exam interview notes which evince that Plum told Bennett the Illustrations were forward looking during their first conversation? The Division also contends that the discovery of a mathematical and disclosure error on the '73 Illustration shows Lucia has not recognized he did anything wrong. To be clear, Respondents **volunteered** the existence of the errors and gave unrebutted testimony that the errors were discovered well after

Lucia had ceased using the slides. If anything, the fact that Respondents volunteered the existence of the errors after it was clear the Division and its expert had also not caught the errors and never would have but for Respondents bringing it to the Division's attention, shows integrity and candor.

Based on the foregoing, the Division has failed to satisfy the requisite showing for RJLC's registration to be revoked, Lucia's registration to be revoked and Lucia to be permanently barred from association with any investment adviser or broker dealer. Indeed, the Division's flip statement that Lucia should be barred from association with any registered broker dealer because Lucia "funneled some of the income from his seminars through the broker dealer" is malicious embellishment. DB, 46. Bennett admitted that the Staff examined and raised no deficiencies related to Lucia's compensation structure and the Division made no attempt to prove that any payments to Respondents or any broker dealer were inappropriate, unlawful or questionable in any way.[60] Tr. 105. The purpose or expulsion or suspension is to protect investors, not as a penalty. *McCarthy v. SEC*, 406 F.3d 179, 188 (2nd Cir. 2005); *Assoc. Sec. Corp. v. SEC*, 283 F.2d 773, 775 (10th Cir. 1960). The fact that no seminar attendees lost any money or complained, coupled with the fact that the Illustration have not been used in two years demonstrates that the investing public will not be further protected by a suspension or expulsion of Respondents from the industry.

Finally, with respect to monetary sanctions, the Division contends that third tier penalties are appropriate. Section 203(i) of the Advisers Act provides:

(i) Monetary Penalties in **Administrative Proceedings** –

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[60] The 2010 Exam Report states, "If RJLC receives compensation for client investments in Buckets 1 or 2, it is in the form of commissions **resulting from its employees' status as registered representatives of First Allied** or as licensed insurance agents." RX 50, LA-SEC3937-005768.

> (2) Maximum Amount of Penalty –
> (C) Third Tier. - Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $100,000 for a natural person or $500,000 for any other person if—(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (ii) such act or omission directly or indirectly **resulted in substantial losses** or created a **significant risk of substantial losses to other persons** or resulted in **substantial pecuniary gain** to the person who committed the act or omission.(emphasis added)

Without citation to any evidence, the Division states that "Respondents obtained substantial pecuniary gain from their conduct." DB, p. 46.[61] **This Court should consider carefully the significance of this statement as it is indicative of the Division's entire case.** Notwithstanding wasting a significant period of Hearing time on the irrelevant issue of the "gross revenues" earned by Lucia Financial, the **Division made no effort to prove that Respondents received any, let alone "substantial," pecuniary gain from the presentation of the Illustrations at the BOM seminars.** The Division has made no showing that **any** monetary penalties are appropriate.[62] This proceeding has shattered Lucia's career, ravaged his reputation and resulted in the loss of jobs for dozens of employees, and the Division can't even bother to support its request for $875,000 in penalties with citation to evidence? The Division's position is symptomatic of its intransigent investigation and prosecution of this proceeding. When confronted with evidence vindicating Respondents, such as the Webinar, the 2003 examination, examples of identical retirement planning industry illustrations, and compliance submissions,

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61 In *SEC v. Locke Capital Management, Inc.*, 794 F. Supp.2d 355 (D. R.I. 2011), the court denied third-tier penalties where the Commission did not detail how the respondent caused substantial loss or the risk thereof to others. *Id.* at 370. The Division has not articulated a basis for any monetary sanctions. As shown, *supra*, the Division has failed to link any pecuniary gain to the Illustrations, let alone quantified such amounts or shown that that such amounts were not the result of client referrals, existing clients, or radio referrals. Tr. 1557-8, 64, 97.

62 If the Division's gambit is to request an outrageous, unsubstantiated amount as a ruse to get some lesser amount or tier level awarded by default, this is inequitable and prejudicial. Respondents should have the opportunity to address the amount and tier level of sanctions at issue.

instead of admitting that Lucia was not knowingly violating any securities laws, the Division sought to bury him. Nothing the Division has done here is consistent with its mission to protect the investing public.

For these reasons, the Division's request for the imposition of a cease and desist order, an order to disclose at all future seminars that Lucia has been "sanctioned for providing misleading performance data about the BOM portfolio strategy," revocation of registration, permanent bars and monetary penalties should be denied and the proceeding dismissed.

IV. CONCLUSION

For the foregoing reasons, the OIP should be dismissed.

Dated: February 22, 2013

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